Australian Government

International Comparison of Australia’s Taxes

3 April 2006

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The Hon Peter Costello, MP
Treasurer
Parliament House
Canberra ACT 2600

Dear Treasurer

We are pleased to present to you the report on the International Comparison of Australia's Taxes.

This study has provided an important opportunity to inform the public discussion about Australia's taxation arrangements. We believe that the information contained in the report delivers some significant insights into the taxation arrangements both within Australia and in other countries around the world.

The study attracted wide public interest and, although there was no formal submission process, there were over one hundred submissions, many of which raised particular taxation policy measures. We would specifically like to note the input of Deloittes, Ernst and Young, KPMG, PricewaterhouseCoopers and the Institute of Actuaries of Australia in providing assistance to determine the details of taxation arrangements in other countries.

We hope that the broader view of Australia's taxation arrangements which can be gained from this report will allow Australians the opportunity to consider the role of such measures in their international context.

Yours sincerely

R. F. E. Warburton, AO

P. W. Hendy

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TERMS OF REFERENCE

TERMS OF REFERENCE FOR AN OVERVIEW OF HOW AUSTRALIA'S TAX SYSTEM COMPARES INTERNATIONALLY

The study will compare Australia's taxation system with other countries. The aim of the study is to provide an authoritative statement on the public record about how Australian taxes compare to those in other countries. This will help inform discussion about Australia's tax system.

The focus of the study will be on the provision of objective, descriptive information on Australia's tax and revenue system compared with that of other OECD countries. The study will provide information on the overall level of taxes, the tax mix, and the base and rates within each type of tax. As appropriate, the study also will provide information on the publicly stated rationales for different countries' balances between efficiency, effectiveness and simplicity in the revenue raising effort of these countries.

The study will cover all forms of taxation collected in Australia at national, state and local government levels. This is OECD standard practice for international tax comparisons.

The study will cover personal, business, indirect, property and transaction taxes. On personal taxes, in line with the recommended OECD approach, information will be provided on taxes levied on both individuals and businesses for social insurance purposes, as well as particular forms of social benefits that can be provided through either the tax system or through social security expenditures.

The study will also cover taxes on superannuation, taking account of the very different ways that retirement income objectives are provided in other countries.

The study will make comparisons with all OECD countries, largely reflecting the availability of comprehensive and comparable information on their tax systems. These countries cover most of our largest trading partners, as well as the sources and destinations of most of our capital investment. As determined by the authors, the analysis may extend beyond the thirty OECD countries where comparable information is readily available and issues relevant to the study would benefit from a broader analysis.

For context, the study will provide an overview of the fiscal situation in each of the comparator countries. Some countries have a much larger/smaller government sector than Australia, and therefore require a higher/lower level of taxes. Additionally, information will be provided on the fiscal situation of comparator countries (especially in terms of budget surpluses or deficits).

Where relevant and possible, the study will also cover non-tax revenues and provide information on the extent and composition of tax expenditures in comparator countries.

Given the broad scope of the study, and the considerable amount of information and analysis that will need to be covered, the study necessarily will provide an overview of relevant issues for international comparisons of tax systems. Greater detail will be provided in some areas, especially on personal and business taxes.

The study is to be completed and passed to the Treasurer by 3 April 2006. Due to the short period of the study, there will be there no formal submission process. However, you can still contact the study or provide comments. Further information is available on the following website: http://comparativetaxation.treasury.gov.au.

The study will be undertaken by Mr Richard (Dick) Warburton AO and Mr Peter Hendy. It will be supported by a small secretariat from within the Treasury. The study secretariat can be contacted through the following address: ComparativeTaxation@treasury.gov.au or by ringing (02) 6263 3033.

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The authors wish to give special acknowledgement to the team within Treasury who acted as the Secretariat for this review. To collect the data, analyse it, prepare the report and then carry out the necessary quality assurance, all in such a very short period of time, required a Herculean effort. Their dedication and long working hours, well beyond normal, deserve our special thanks.

Table 1: Secretariat members

Bazen, Derek	Graziani, Robert	Lobo, Audrey
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The authors give similar acknowledgement and thanks to the many who helped with their submissions. In particular, Deloitte, Ernst & Young, KPMG, PricewaterhouseCoopers and the Institute of Actuaries of Australia voluntarily supplied very valuable input from their local and overseas resources in a remarkably short time frame.

In addition, the Secretariat would like to acknowledge the assistance provided by a range of officers from within the Department of the Treasury and other departments and agencies, and in particular the efforts of the production team in bringing the report to a final presentation standard.

Table 2: Production team

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ACRONYMS

ABS	Australian Bureau of Statistics
AMTI	alternative minimum taxable income
ASEAN	Association of Southeast Asian Nations
ATO	Australian Taxation Office
ATR	average tax rate
avg	average
AW	average worker
AWE	average weekly earnings
AWOTE	average weekly ordinary time earnings for full-time adults
CBIT	comprehensive business income tax
CBO	Congressional Budget Office
CEN	capital export neutrality
CFC	controlled foreign company
CGT	capital gains tax
CIT	corporate income tax
CPI	consumer price index
CPT	corporate profit tax
CTR	corporate tax rate
EATR	effective average tax rate
EET	exempt-exempt-taxed
EMTR	effective marginal tax rate
ERM	exchange rate mechanism
EU	European Union
FDI	foreign direct investment
FIF	foreign investment fund
FTC	foreign tax credit
GDP	gross domestic product
GFS	Government Finance Statistics
GNI	gross national income
GST	goods and services tax
ICT	information and communications technology
IMF	International Monetary Fund
LCT	luxury car tax
MTAWE	male total average weekly earnings
MTR	marginal tax rate
NOL	net operating loss

Acronyms (continued)

NSW	New South Wales
OECD	Organisation for Economic Co-operation and Development
OECD Model	OECD Model Tax Convention on Income and on Capital
PAYE	pay as you earn
PPP	purchasing power parity
R&D	research and development
SME	small and medium enterprise
SSC	social security contribution
STS	Simplified Tax System
TES	Tax Expenditures Statement
VAT	value added tax
WET	wine equalisation tax
WHT	withholding tax
WST	wholesale sales tax
WTO	World Trade Organization

Executive Summary

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EXECUTIVE SUMMARY

INTRODUCTION

The objective of this report is to provide an authoritative statement on how Australia's taxes compare with those in other countries, without making policy recommendations or judgments. Where possible, the report provides a full comparison of Australia's tax system with those of other advanced economies, as represented by the membership of the OECD. In places, comparisons are also drawn with other developed and developing economies in our region. In other places, particularly in respect of the reporting of detailed tax design features, it was not possible for this study to cover all of these countries, so a subset of comparator countries (the OECD-10) was selected. The other nine members of the subset are: Canada, Ireland, Japan, the Netherlands, New Zealand, Spain, Switzerland, the United Kingdom and the United States.

These nine members of the OECD-10 were chosen because they are broadly similar to Australia in terms of their overall tax to GDP ratio and the role of the government sector in their economies (Chapter 1 provides further details). The size of the subset needed to achieve a balance between the degree of similarity between the comparator countries and a sufficiently large sample of countries to provide meaningful comparisons without imposing excessive information collection demands.

The comparison of countries' tax regimes is a challenging task. Caution is paramount in drawing conclusions from such comparisons, because statistical tools, data sources, aggregation issues and assumptions can affect the reliability of the comparisons. Moreover, comprehensive tax comparisons could not be made in all areas due to a lack of data and to methodological issues with the studies that have been conducted. This limitation applies for retirement savings, tax administration and compliance costs and the use of tax expenditures.

The report shows that Australia is a low-tax country. Australia's overall tax burden (31.6 per cent), measured as the tax to GDP ratio, is the eighth lowest of the 30-member OECD. Australia's mix between direct and indirect taxation is in line with other OECD countries, although the composition differs. For example, Australia's indirect tax mix differs through a lower reliance on value-added and sales taxes, and a relatively higher reliance on property and transaction taxes, further, Australia does not levy any wealth, estate, inheritance or gift taxes.

Australia's total wage and salary tax take as a proportion of GDP is low compared with the OECD-30 and the OECD-10. While Australia's individual income tax burden is relatively high compared to the OECD-30 and OECD-10, once social security contributions and payroll taxes are accounted for, Australia has the second lowest level of direct taxation on individuals and payroll in the OECD-10.

Australia's company income tax as a proportion of GDP is above that of the other OECD-10 countries, but there are classification issues concerning this comparison. Australia's statutory

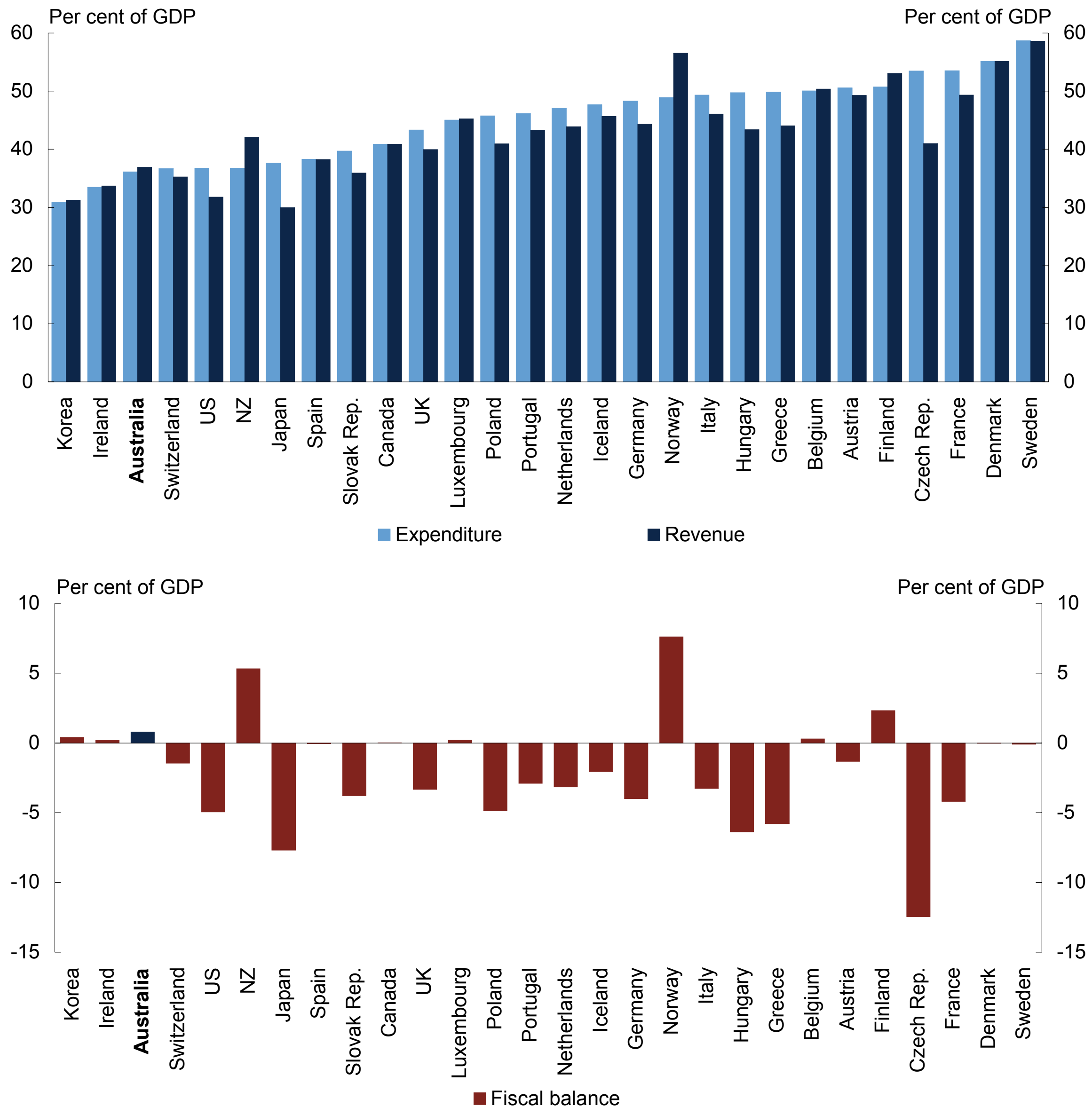
corporate tax rate is in line with OECD-30 and OECD-10 averages. Australia's treatment of depreciation, losses and goodwill is generally less favourable.

Australia's reliance on property and transaction taxes, which are virtually all levied by State, Territory and local governments, is relatively high compared with the OECD-30. Australia's reliance on property and transaction taxes is more in line with the OECD-10, despite having the highest tax burden on financial and capital transactions.

THE ROLE OF TAXES IN PUBLIC FINANCE

Communities face important choices about how particular goods and services should be provided. In broad terms, these choices can be private provision, regulation, or government provision. The choices have significant impacts on measures of the size of government expenditure or government revenue.

- In 2003, Australia had the third lowest government expenditure as a proportion of GDP of 28 OECD countries (Mexico and Turkey do not provide comparable data) and the second lowest of the OECD-10 (see Chart 1).
- The primary reason that Australia was the third lowest spending, yet eighth lowest taxing OECD country, is that many of the higher spending countries were running fiscal deficits in 2003.



Source: OECD *Economic Outlook No. 78*, 2005.

A STATISTICAL OVERVIEW

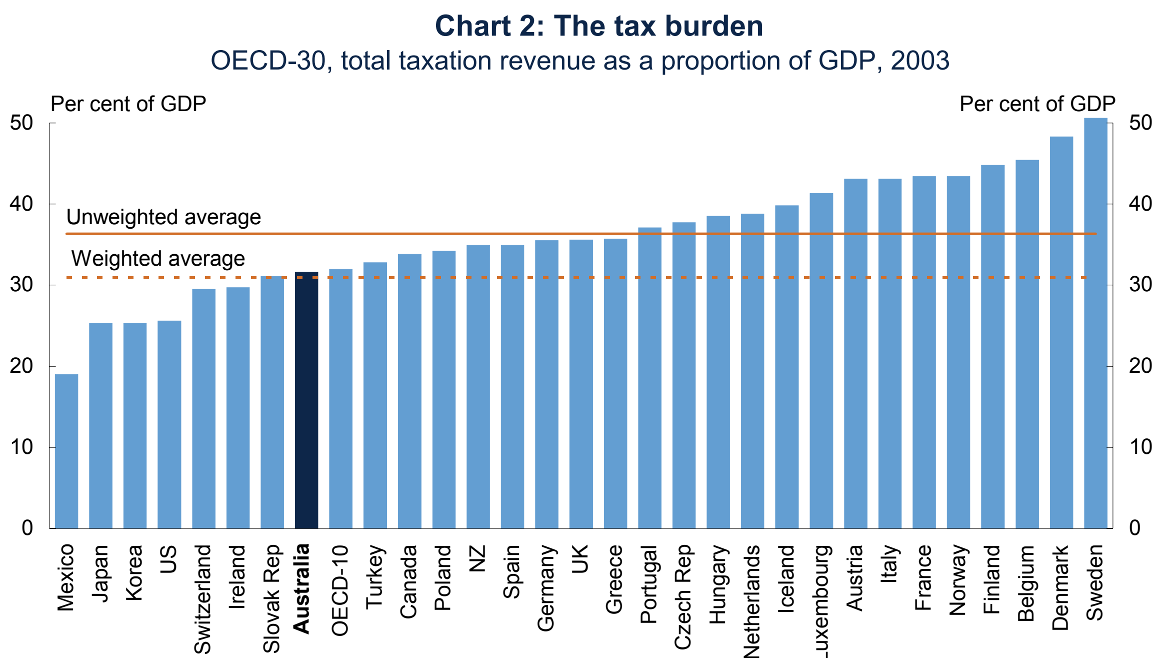
Australia has a low overall tax burden compared with the OECD-30, both currently and historically. Australia's tax mix is in line with OECD-30 countries, although there are some distinguishing features.

- Australia is the eighth lowest taxing country of the OECD-30.
- Australia's tax burden has typically ranked in the bottom third of countries since 1965.

- Australia's tax to GDP ratio of 31.6 per cent is below the unweighted OECD-30 average of 36.3 per cent and above the GDP-weighted OECD-30 average of 30.9 per cent (see Chart 2).

Chart 2: The tax burden

OECD-30, total taxation revenue as a proportion of GDP, 2003

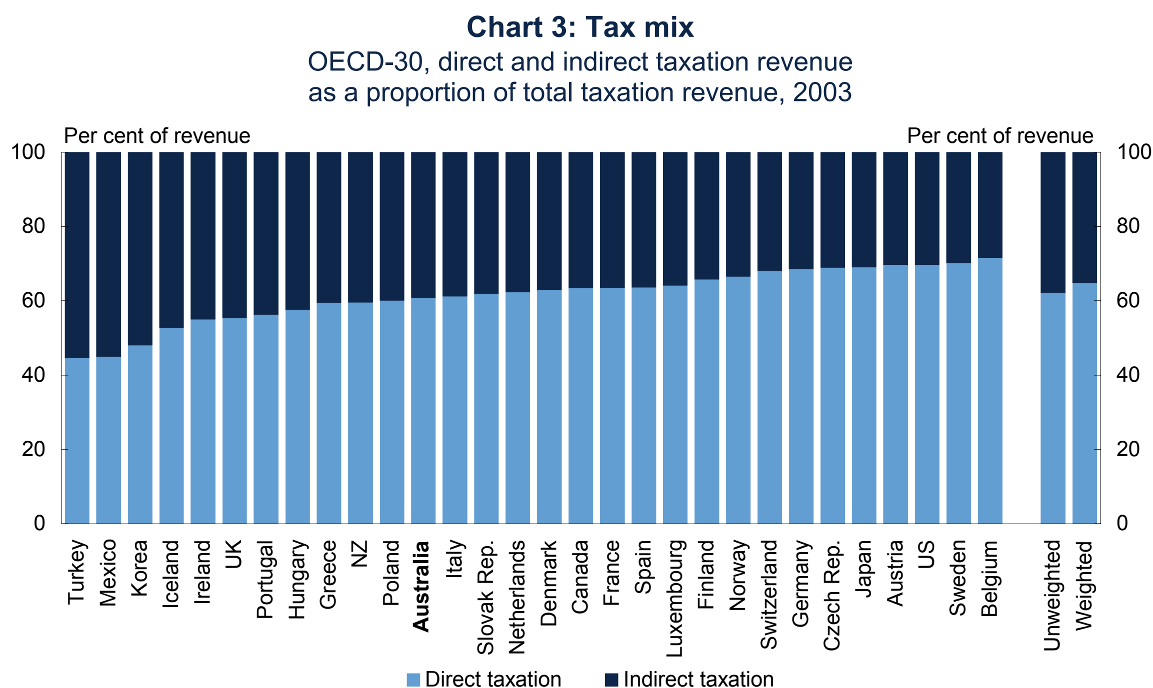


Source: OECD *Revenue Statistics*, 2005.

- Like most other advanced countries, Australia raises the majority of its taxation revenue (60.9 per cent compared with the OECD-30 unweighted average of 62.2 per cent) from direct taxation levied on incomes and payrolls. The remaining 39.1 per cent of Australia's taxation revenue is derived from indirect taxation — including the goods and services tax, excise and customs duty, and property taxes (see Chart 3).

Chart 3: Tax mix

OECD-30, direct and indirect taxation revenue as a proportion of total taxation revenue, 2003



Source: OECD *Revenue Statistics*, 2005.

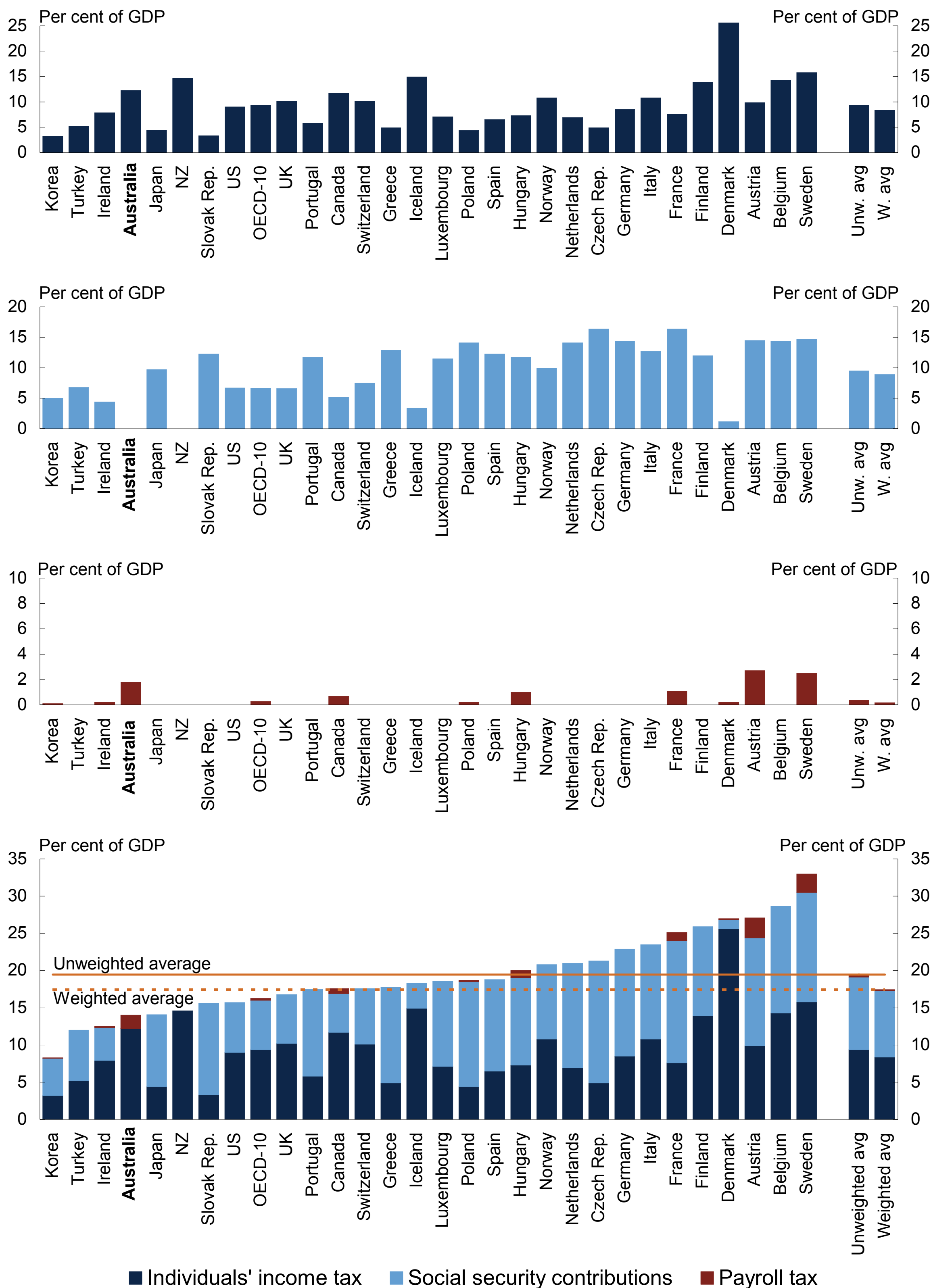
WAGE AND SALARY TAXATION

Australia's total wage and salary tax take as a proportion of GDP is low compared with the OECD-30 and OECD-10. While Australia's individual income tax take is relatively high compared to the OECD-30 and OECD-10, once social security contributions and payroll taxes are taken into account Australia's direct taxation on individuals and payroll is relatively low.

- Australia's direct taxation of individuals and payroll is 14.0 per cent of GDP, which is the fourth lowest in the OECD-30 (see Chart 4) and second lowest in the OECD-10.
- Australia's top marginal tax rate of 48.5 per cent is:
  - the eleventh highest in the OECD-30 and around 2 percentage points higher than the unweighted OECD-30 average (46.7 per cent) (see Chart 5); and
  - the second highest of the OECD-10 and around 3 percentage points higher than the OECD-10 average (45.8 per cent).
- Australia's threshold for the top marginal tax rate is slightly lower than the averages for both the OECD-30 and the OECD-10 (see Chart 5).

Chart 4: Components of direct taxation in respect of individuals and payrolls

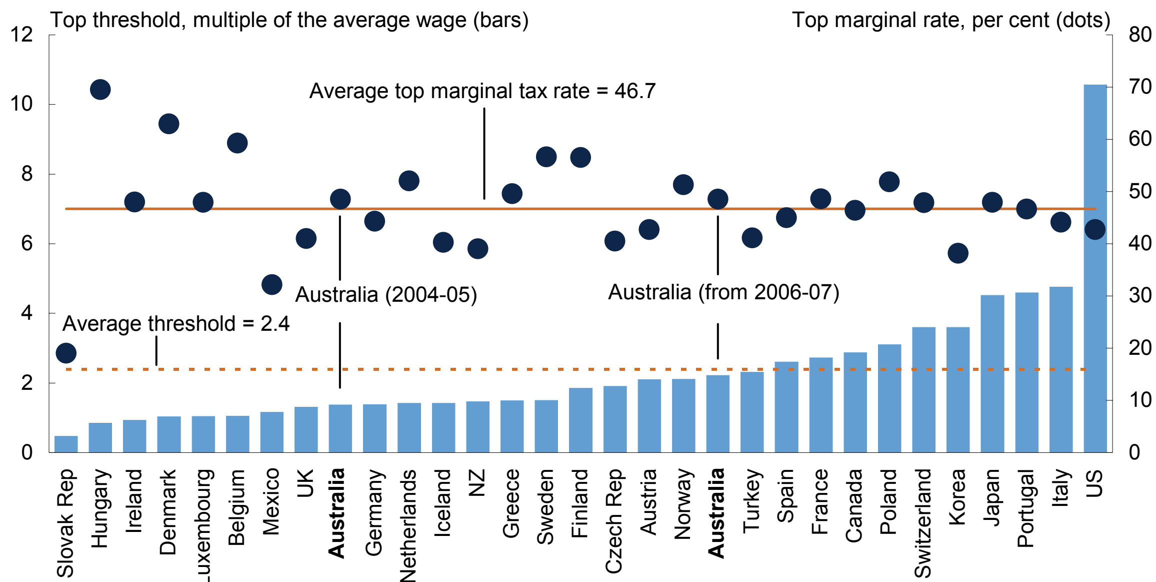
OECD-30, taxation revenue as a proportion of GDP, ordered by tax burden, 2003[(a)]



(a) For the purpose of international comparison, there are significant risks in relying on disaggregated data, especially in disaggregating taxes on income, profits and capital gains into its individuals, corporate and other components. A description of these is provided in Appendix 3.1. Mexico doesn't provide a disaggregation of its income taxes.

Source: OECD *Revenue Statistics*, 2005.

Chart 5: Top marginal tax rates and thresholds (unweighted averages)
OECD-30, 2005

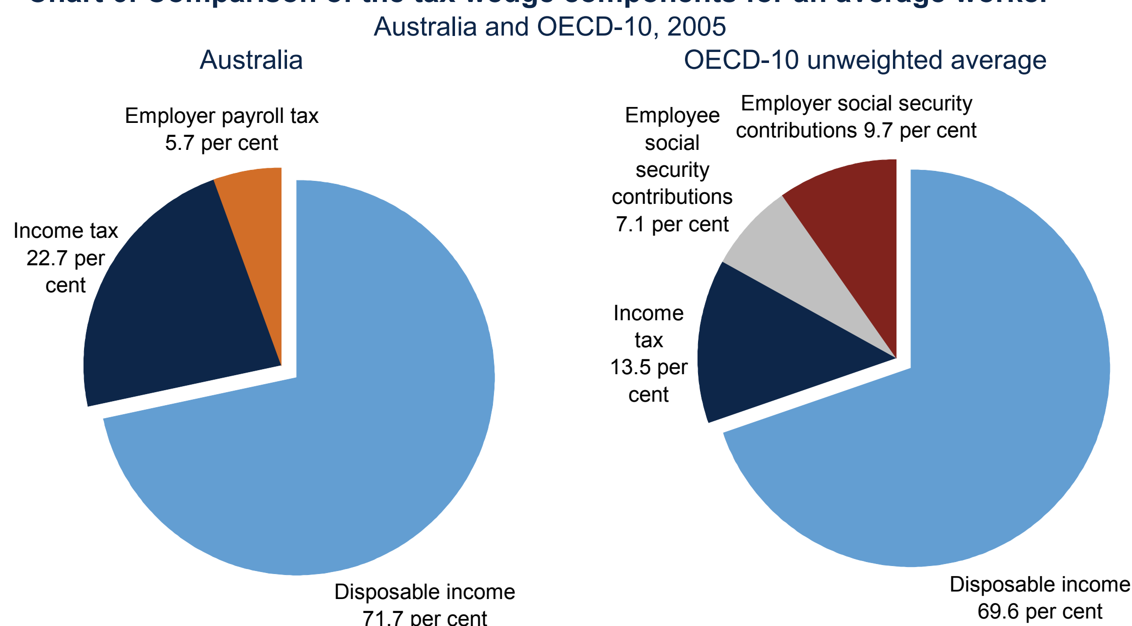


Source: OECD Tax Database (preliminary).

- The combined progressivity of Australia's personal income tax system and welfare system is higher than for most of the OECD-10.
- As a result of Australia's tightly targeted welfare system, effective marginal tax rates are generally higher than those in the other OECD-10 countries.
- Australia's tax wedge (the difference between the total labour cost to an employer, and the corresponding disposable income of an employee) is consistently ranked among the lowest eight in the OECD-30 for each of the eight family types considered and is in the bottom half of the OECD-10 for most family types. The tax wedge and its composition for an average worker in Australia and the average for the OECD-10 is shown in Chart 6.
- Based on available information, at least three of the OECD-10 countries automatically index their personal income tax thresholds to inflation each year.

Chart 6: Comparison of the tax wedge components for an average worker[(a)]

Australia and OECD-10, 2005



(a) Refers to a single average worker with no dependants.
Source: OECD *Taxing Wages, 2005*.

CORPORATE TAXATION

Australia's corporate income tax as a proportion of GDP is above that of the OECD-10, but there are classification issues concerning this comparison.

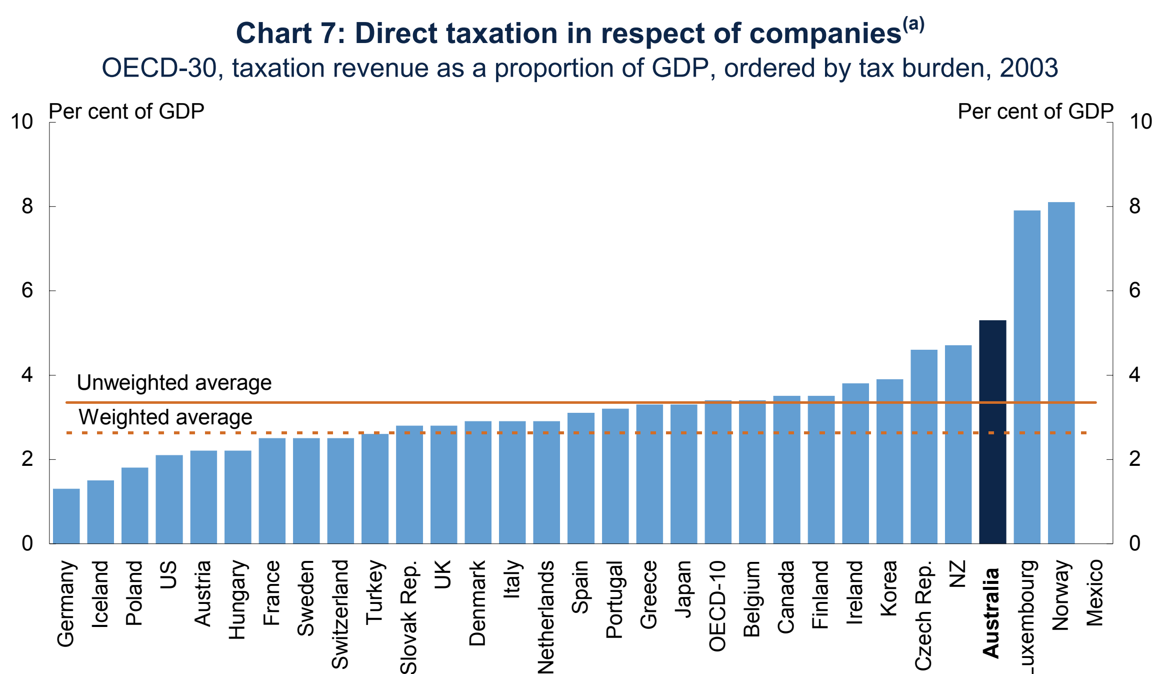
- Australia's corporate tax take as a proportion of GDP (5.3 per cent) is:
  - the third highest of the OECD-30, and is 2 percentage points above the unweighted OECD-30 average (3.3 per cent) and is around 2.5 percentage points above the weighted average (2.6 per cent) (see Chart 7); and
  - the highest of the OECD-10, and is around 2 percentage points above the OECD-10 average (3.4 per cent).
- From 2000, the reduction in Australia's corporate tax rate has exceeded the fall in both the OECD-30 and the OECD-10 averages.
- Australia's 30 per cent statutory corporate tax rate is:
  - slightly above the OECD-30 unweighted average of 28.5 per cent and below the weighted average of 35.6 per cent (see Chart 8); and
  - the equal fourth lowest of the OECD-10 and slightly below the OECD-10 average of 30.8 per cent.
- Australia has the third highest effective marginal tax rate (the effective rate on an additional dollar of an investment earning a normal profit) of the OECD-10 (24.3 per cent) for investment in plant and equipment financed by equity.

- Australia has the fourth highest effective average tax rate (the proportion of pre-tax above-normal profit the investor gets to keep after paying corporate tax) of the OECD-10 (26.2 per cent) for an investment in plant and equipment financed by equity.

- Australia has the equal lowest value of depreciation allowances of the OECD-10 for plant and equipment.

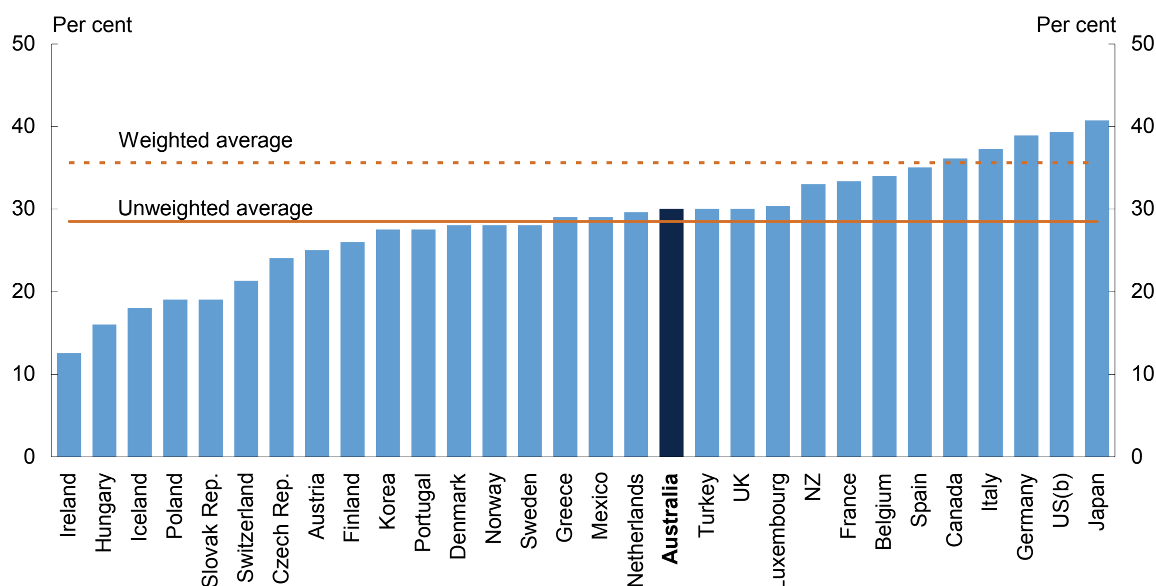
- Half of the OECD-10 countries permit loss carry back and over half allow the amortisation of goodwill, neither of which Australia permits.

- With the exception of New Zealand, all of the OECD-10 countries impose some general form of corporate capital gains tax. There are significant variations in the rate of capital gains tax depending on the nature and level of the shareholding.



(a) For the purpose of international comparison, there are significant risks in relying on disaggregated data, especially in disaggregating classification 1000 (income taxation revenue).
Source: OECD *Revenue Statistics*, 2005.

Chart 8: Full statutory corporate tax rates[(a)]
OECD-30, 2005



(a) Rates are full (national, sub-national and surcharge) statutory corporate tax rates.
(b) The rate for the United States is the OECD full statutory corporate tax rate for 2005, which is the latest available OECD rate.
Source: OECD Tax Database; KPMG (2005).

Capital income taxation

Australia's taxation of capital income is broadly in line with that of the OECD-10, although there are some significant differences with other members of the OECD-30, such as the Nordic countries that have adopted a schedular tax approach. Australia's overall rates on dividend income and capital gains are generally lower than, or in line with, the rates applying across the OECD-10, although Australia has a higher top rate of tax on interest income.

- Australia is one of only a small number of OECD-30 countries that have a dividend imputation system (where the credit depends on company tax paid). Unlike most of the other OECD countries with an imputation system, Australia's system refunds excess imputation credits eliminating the double taxation of dividends. Most countries use a credit system (where the credit does not depend on company tax paid) or have a modified classical system with a reduced rate on dividends to relieve the double taxation of dividend income.

- Australia has the third lowest overall tax rate of the OECD-10 on dividend income for an individual on the top marginal tax rate, taking account of tax at both the company and the shareholder level (see Chart 9).

- Australia has the second lowest overall tax rate of the OECD-10 on dividend income for an individual earning the average wage, taking account of tax at both the company and the shareholder level.

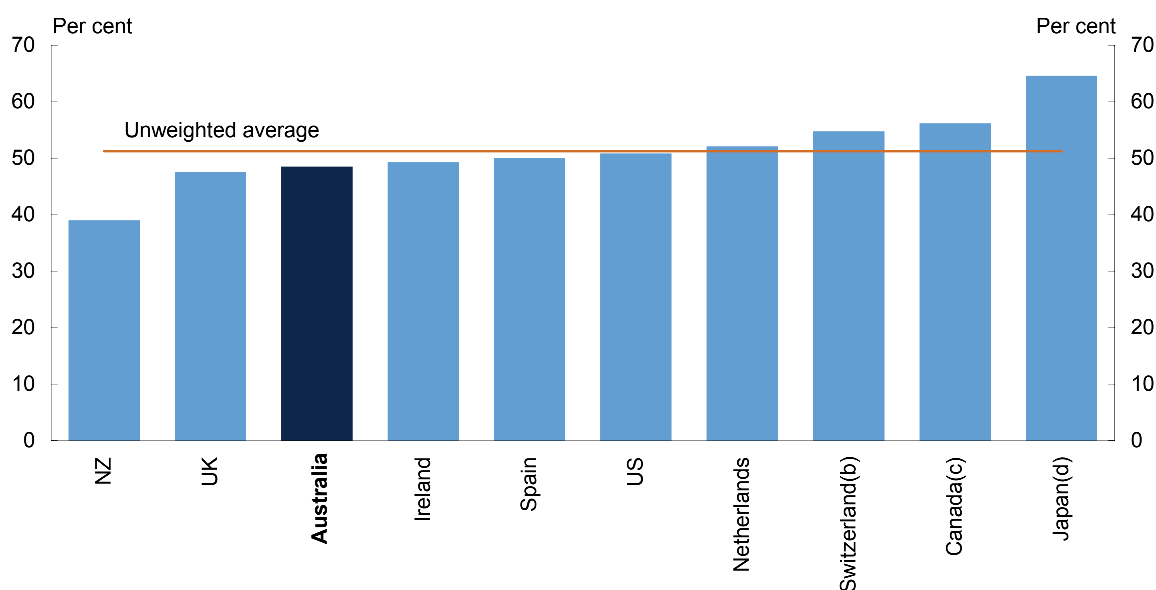
- All of the OECD-10 countries, including Australia, provide some form of concessional treatment for capital gains.

- Australia has the third highest top capital gains tax rate for shares held between one and two years, and the second highest top capital gains tax rate for shares held for ten years, of the OECD-10 (see Chart 10).

- Australia has the highest top marginal tax rate on interest income of the OECD-10 (see Chart 11).

- Most countries in the OECD-10 have a lower tax rate on interest income compared with the all-in tax rate on wage and salary income. In many cases, this is because social security contributions do not apply to capital income.

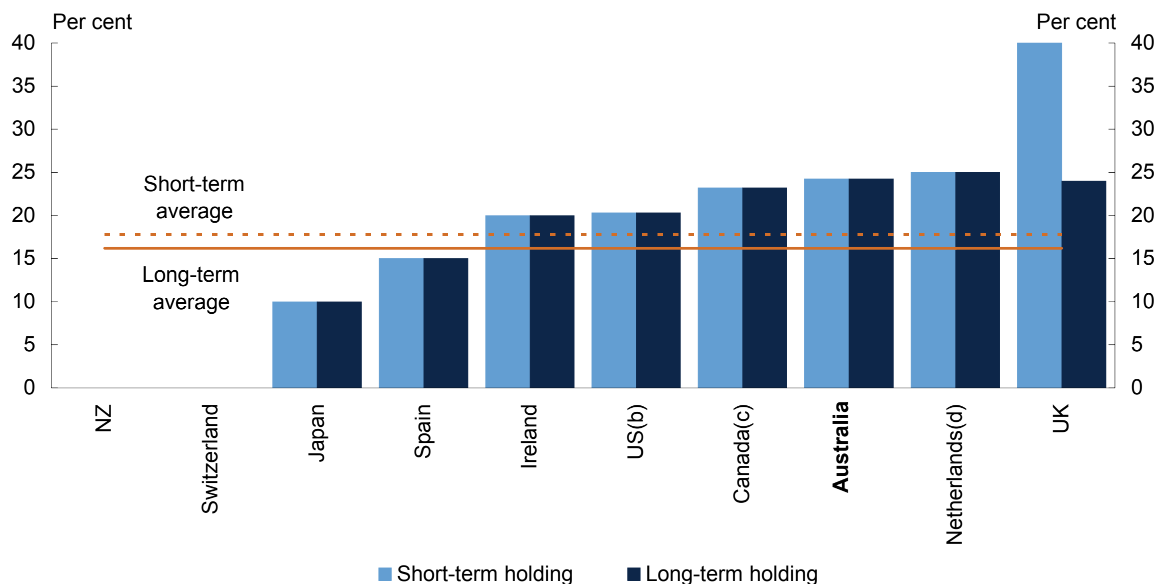
Chart 9: Top overall statutory tax rates on domestic source dividend income[(a)]
OECD-10, 2005



(a) Overall statutory tax rates on distributions of domestic source income to a resident individual shareholder, incorporating corporate income tax, personal income tax and any type of shareholder relief.
(b) The corporate income tax rate includes the church tax, while the personal income tax rate excludes it.
(c) Canada recently announced a reduction in personal income taxes on eligible dividends.
See http://www.fin.gc.ca/news05/data/05-082_1e.html for further details.
(d) The 2005 rate for Japan was not available; the 2004 rate is presented.
Source: OECD Tax Database.

Chart 10: Top marginal tax rate on capital gains on shares[a]

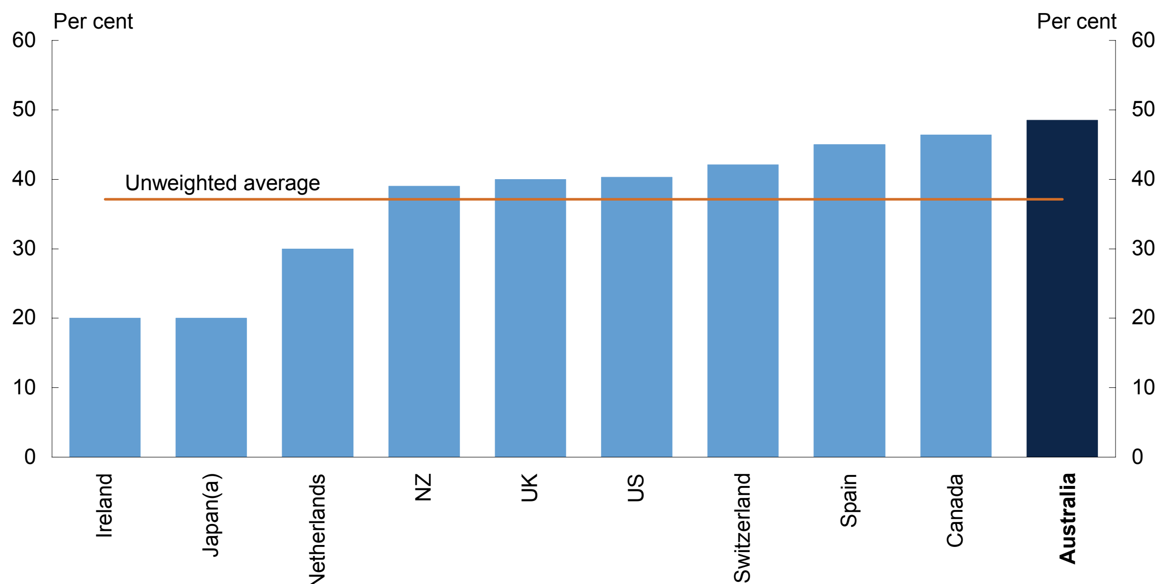
OECD-10, 2005-06



(a) Where relevant based on top marginal income tax rates, short-term holdings are greater than one year but less than two years, long-term holdings are where the shares have been held for 10 years.
(b) The rate includes federal, state and city taxes with the last two being based on Michigan and Detroit.
(c) Cumulative life-time capital gains exemption (C$500,000) under certain conditions. Rate includes national and sub-national taxes, the latter being based on the representative Province of Ontario.
(d) For substantial shareholders (direct or indirect ownership of more than 5 per cent); otherwise exempt.
Source: Various, see Chapter 1 (1.4.1).

Chart 11: Top marginal tax rate on interest from ordinary bank accounts

OECD-10, 2005



(a) Japan provides an exemption for interest accrued from current bank deposits, however interest from other deposits is taxable.
Source: Various, see Chapter 1 (1.4.1).

Australia's difference between the top marginal personal tax rate and full statutory corporate tax rate is broadly in line with the average difference for the OECD-30 (see Chart 12) and above the average difference for the OECD-10.

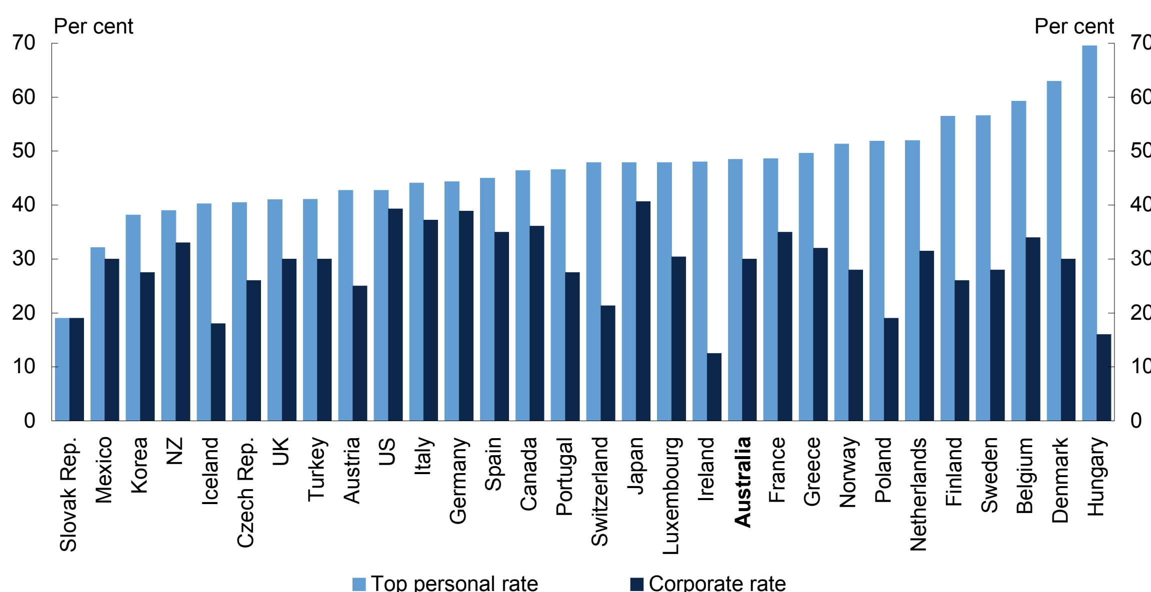
- Of the 30 OECD countries, only one, the Slovak Republic, has aligned its top marginal personal tax rate and full statutory corporate tax rate.

- Australia's difference of 18.5 percentage points is:

  – the thirteenth highest of the OECD-30, and only slightly above the OECD-30 average (17.8 percentage points); and

  – the fourth highest of the OECD-10 and around four percentage points above the OECD-10 average (14.9 percentage points).

Chart 12: Top marginal personal tax rate and full statutory corporate tax rate
OECD-30, 2005



Source: OECD Tax Database; KPMG (various); Deloitte (2006); various country websites.

Retirement savings taxation

It is not possible to draw an overall conclusion about the relative ranking of the concessionality of the Australian retirement income taxation system owing to the lack of data and to methodological issues with the various studies on this subject.

- The Australian retirement savings taxation regime, like those of other countries, is concessional compared to the taxation treatment of other savings (for example, a bank account).

- While there is no standard 'international model' of retirement savings taxation, eight countries out of the OECD-10 only tax end benefits. The two exceptions are Australia and New Zealand. However the most important point about the overall concessionality of the taxation arrangements is the rate(s) of tax imposed.

- When compared with the OECD-10, Australia is placed about mid-range for the generosity of its contribution limitations and provides above-average concessions in terms of the availability and taxation treatment of lump sum payments.

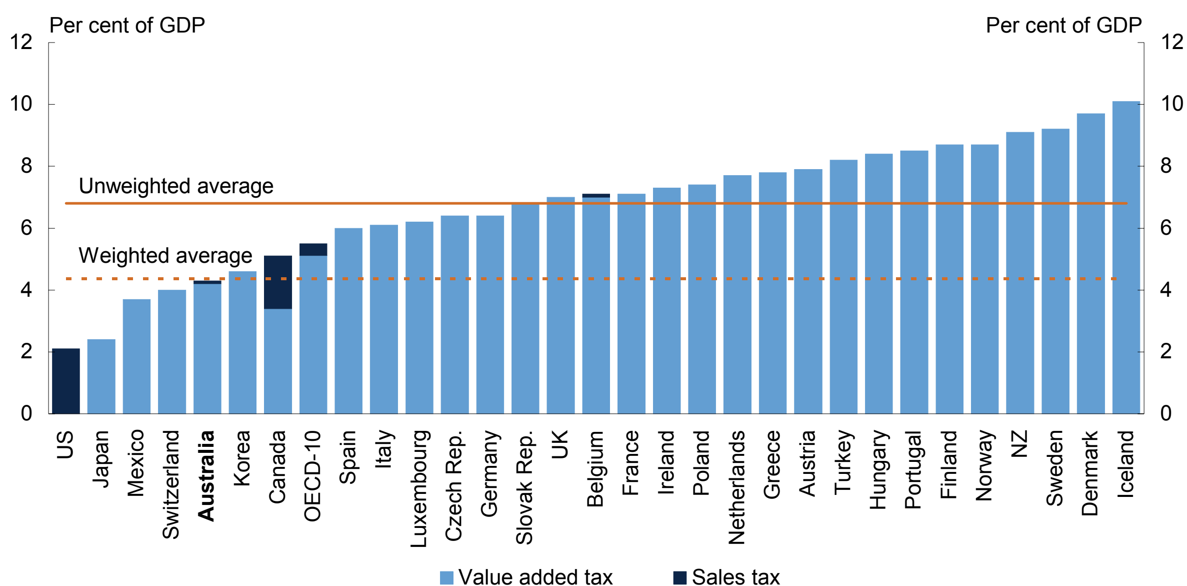
TAXATION OF GOODS AND SERVICES

Australia's tax take from goods and services is broadly in line with that of the OECD-10, although it has a higher reliance on excise and customs duties. Australia's tax rate on general consumption is significantly lower than the average rates across the OECD-30, while its fuel excise duty rates are among the lowest in the OECD-30.

- Australia's reliance on goods and services taxes is the fifth lowest in the OECD-10, at 9.4 per cent of GDP, only marginally higher than the OECD-10 average (9.2 per cent).
- Australia's indirect tax mix has a lower reliance on value added and sales taxes (4.3 per cent of GDP). Australia's tax burden is the fifth lowest in the OECD-30 and is significantly lower than the OECD-30 unweighted average (6.8 per cent) and slightly lower than the OECD-30 weighted average (4.4 per cent), (see Chart 13).
- Australia's 10 per cent statutory rate on general consumption is the equal fourth lowest of the OECD-30 and is significantly below the OECD-30 unweighted average of 17.6 per cent (see Chart 14).
- Australia's reliance on excise and customs duty of 3.4 per cent of GDP is the third highest of the OECD-10 and around one percentage point higher than the OECD-10 average.
- Australia's excise duty rate on unleaded petrol of 38.143 cents per litre was the fourth lowest of the OECD-30 as at 1 January 2005 (see Chart 15).

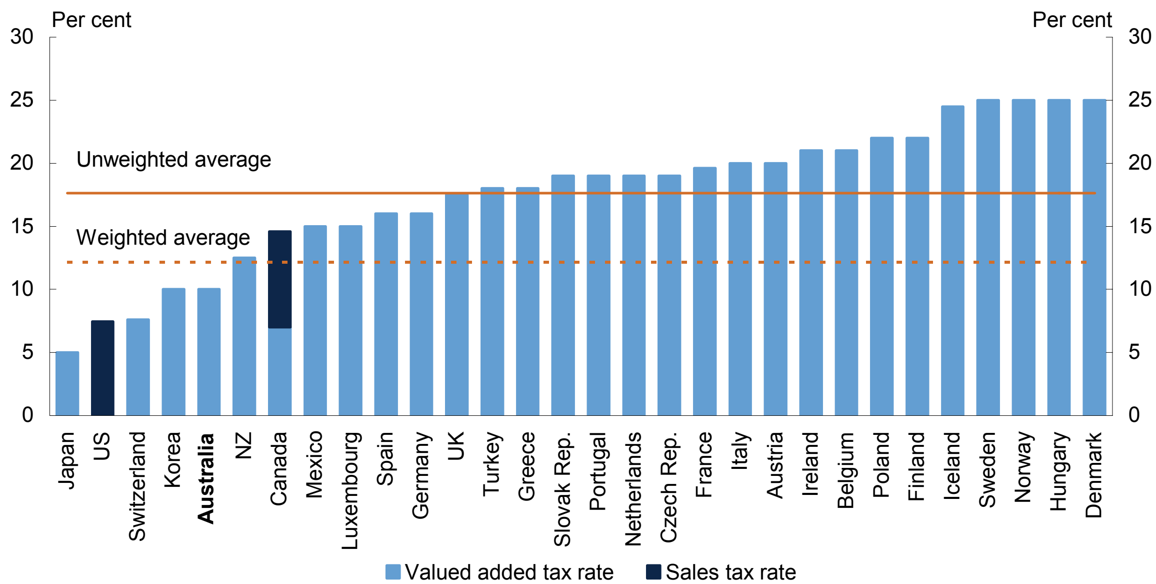
Chart 13: Value added and sales tax burden

OECD-30, taxation revenue as a proportion of GDP, ordered by tax burden, 2003



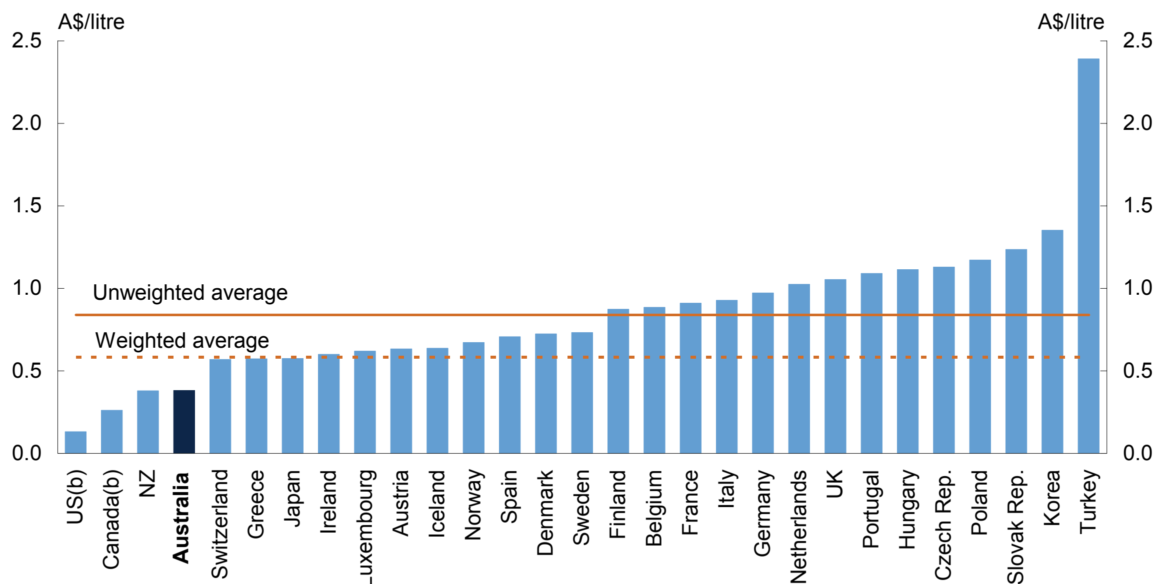
Source: OECD *Revenue Statistics*, 2005.

Chart 14: Value added and sales tax rates
OECD-30, 2005



Sources: OECD Tax Database; Federation of Tax Administrators website; PricewaterhouseCoopers (2005).
Notes: The VAT rates shown are the standard VAT rates for 2005. As state and local sales tax rates for 2005 were not available, the rate shown for the United States is an average of the maximum combined state and local rates as at 1 July 2004 (7.4 per cent). As at 1 July 2004, maximum combined rates varied across the US States from 4 per cent to 11.5 per cent. The sales tax rate for Canada is an average of the provincial sales tax rates (7.8 per cent). Provincial sales tax rates in Canada range from 7 per cent to 10 per cent.

Chart 15: Unleaded petrol excise duty rates(a)
OECD-30, as at 1 January 2005



(a) Rates have been converted to Australian dollars using OECD Purchasing Power Parities. Mexico levies excise duty on unleaded petrol at an ad valorem rate. Hence, the rate per litre varies according to international petrol prices and is not included in the comparison.
(b) In Canada and the United States, both the federal governments and the state/provincial governments levy taxes on unleaded petrol. An average rate has been calculated for the States and Provinces by the OECD/European Environment Agency, and the combined rates are shown.
Source: Australian Treasury estimates based on OECD and European Environment Agency data.

PROPERTY AND TRANSACTION TAXATION

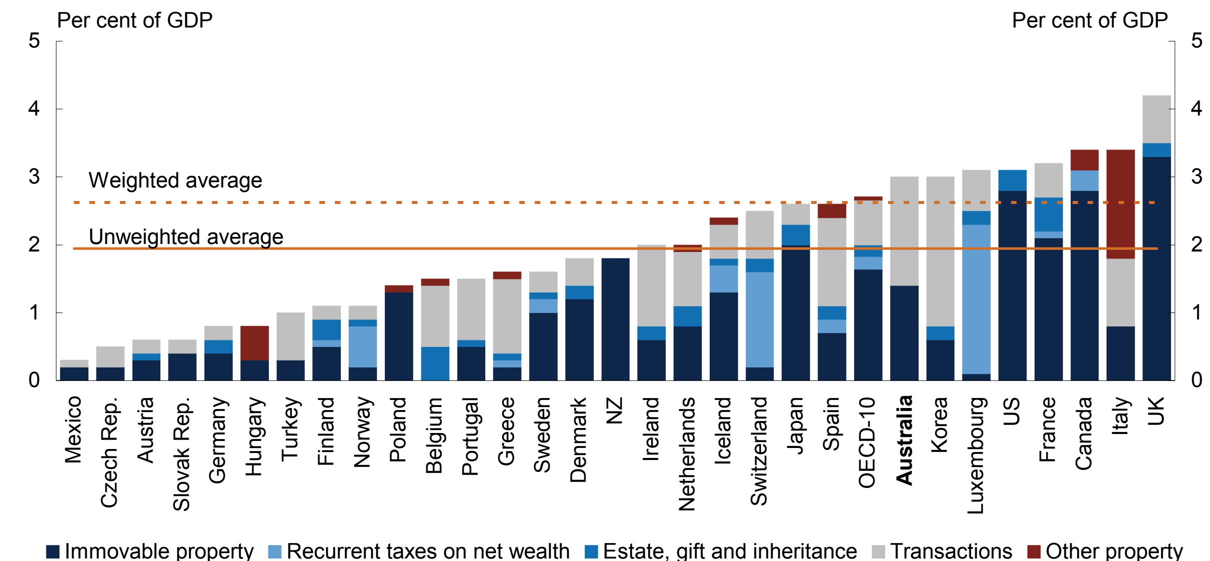
Virtually all property and transaction taxes in Australia are levied by the State, Territory, and local governments. Unlike the other OECD-10 countries, Australia does not levy any wealth, estate, inheritance or gift taxes.

Australia has a comparatively high reliance on property and transaction taxes relative to the OECD-30, but is broadly in line with the average of the OECD-10.

- Australia's reliance on property and transaction taxes of 3.0 per cent of GDP is the seventh highest of the OECD-30, however it is only 0.3 percentage points above the OECD-10 average (2.7 per cent), (see Chart 16).
- Australia's tax burden from taxes on immovable property is below the unweighted average of the OECD-10.
- Australia has the highest financial and capital transaction tax burden of the OECD-10.
- Australia's top rate for stamp duty on conveyances (7 per cent) is the equal second highest of the OECD-10.

Chart 16: Property and transaction tax burden

OECD-30, 2003



Source: OECD *Revenue Statistics*, 2005.

INTERNATIONAL TAXATION ARRANGEMENTS

Australia's international taxation arrangements are consistent with OECD-30 and OECD-10 practices, but there are differences in a few areas including Australia's treatment of the capital gains of non-residents and foreign losses. Measures announced in the 2005-06 Budget will bring Australia more in line with the other OECD-10 countries in these areas.

TAXATION AND LABOUR AND CAPITAL FLOWS

While the taxation regime can be an important factor at the margin in shaping the economic decisions of individuals and companies on where to work and invest, it is only one of a wide range of complex considerations which influence such choices.

SELECTED ASIAN ECONOMIES

The report also considered a comparison of selected Asian economies' tax regimes. Information is provided on the tax mix of the ASEAN countries. In addition, more detailed data is provided on several Asian economies. Singapore and Malaysia were chosen because they are members of ASEAN. Hong Kong was chosen because (along with Singapore) it is cited as being a competitor with Australia for regional headquarters, and because it is an important destination (along with Singapore and Malaysia) for skilled Australians moving overseas on a permanent or long-term basis. Taiwan was chosen, notwithstanding data limitations, because it is an important regional economy and is a significant trading partner with Australia.

The approaches to taxation in the Asian economies often differ significantly from the standard practice in the OECD-10. A number of the Asian economies show a strong dependence on company tax (in 2002 Malaysia collected 8.9 per cent of GDP and Vietnam collected 6.9 per cent of GDP) well in excess of the OECD-10 unweighted average of 3.4 per cent of GDP.

Whilst Malaysia and Singapore have a mix of direct and indirect taxes which is broadly consistent with OECD practice, a number of the Asian economies (for example, Thailand, Cambodia and Myanmar) rely much more heavily on indirect taxes.

The amount of tax revenue collected as a percentage of GDP in 2002 for the selected Asian economies did not exceed 18 per cent. In contrast, in 2003 the OECD-30 unweighted average of tax revenue to GDP was 36.3 per cent.

The average total outlays for the Asian economies tend to be substantially lower than those of the OECD-10, reflecting the fact that many of the Asian economies are still developing. For instance Thailand recorded outlays of 19.9 per cent of GDP in 2004, while the unweighted average for the OECD-10 was 38.6 per cent of GDP.

The issues outlined above reduce the value of attempting to compare the Asian economies with OECD countries. In addition, the quality of the data available for the Asian countries is relatively low. In many instances the data which would be required to draw useful comparisons are not available.

ADMINISTRATION AND COMPLIANCE COSTS OF TAXATION

The report found that there have been few truly comparative international operating cost studies. The main reason for this is that cross-country comparisons are difficult to conduct and need to be treated with caution. Because of these difficulties, no summary is made of data comparing estimates of operating costs across countries.

TAX EXPENDITURES

Differences in tax systems and benchmarks make international comparisons of tax expenditures particularly difficult. As a result of these difficulties no attempt is made to make such comparisons. Instead the report provides a comparison of tax expenditure reporting across selected OECD countries.

- Australia's approach of having a legal requirement to analyse tax expenditures, linking it to the government budget cycle and covering a broad range of taxes, appears to be in line with the approach followed in most OECD countries.

Chapter 1

Introduction and methodology

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1. INTRODUCTION AND METHODOLOGY

1.1 BROAD CONTEXT

The comparison of countries' taxation regimes is a challenging task, and caution is advised when making even simple comparisons between countries, as there are many factors which affect the reliability of any comparison.

While there may be challenges in making robust comparisons between countries for either tax burdens in aggregate, or in relation to specific tax bases, the value and reliability of these comparisons is significantly enhanced when a comparison is made between similar industrialised countries.

It is unlikely any other country's tax system would provide Australia with a better 'off-the-shelf' model for its tax system. Each country's tax system reflects the interplay of numerous economic, social, political, cultural and historical factors that may not be relevant to the design of Australia's tax system.

More specifically, key differences in tax systems between individual countries can be driven by variations in social structures and the values and expectations of its citizens — particularly with respect to equity or fairness, the degree of development of the economy, the extent to which the economy is integrated into the world economy, and differences in delivery mechanisms for achieving social policy objectives.

The aim of this report is to provide reliable information on the taxation arrangements applying in Australia and other countries. The hope is that this will highlight the important features of Australia's taxation arrangements and help inform discussion about Australia's tax system.

This study has been an opportunity to report on a broad range of policy settings from around the world. In doing so, a large amount of information was collected, synthesised and analysed. International trends have been highlighted where relevant, but no policy recommendations have been made with respect to Australia's tax system.

1.2 TERMS OF REFERENCE

The Treasurer commissioned this study to examine and report on how Australia's tax system compares with other developed economies.

The aim of the study was to provide a public report containing objective, descriptive information that compares Australian taxes to those in other countries. The task of the study was to:

- provide information on the overall level of taxes, the tax mix, and the base and rates within each type of tax;

- cover taxes collected at national, state and local government levels including personal, business, indirect, property, transaction and superannuation taxes; and
- make comparisons with all OECD countries, largely reflecting the availability of comprehensive and comparable information on their tax systems.

The study was given the latitude to extend beyond the 30 OECD countries if comparable information was readily available, and if issues relevant to the study would benefit from a broader analysis.

1.3 CHOOSING THE SELECTED COUNTRIES FOR THE REPORT

A threshold issue for this study was the comparator set of countries to be used. Where possible, a full comparison is provided with other advanced economies, as represented by the membership of the OECD. When all 30 or nearly all 30 member countries are included in a comparison, the shortened form used is OECD-30. In places, comparisons are also drawn with other developed and developing countries in our region.

In other places, particularly in respect of the reporting of detailed tax design features, it was not possible for this study to cover all of these countries, so a sub-set of comparator countries was selected. This section explains the selection process.

1.3.1 Alternative rationales

The choice of countries to be compared in any particular study will primarily depend upon the objectives of the study:

- Where the purpose of an investigation is to explore a broad range of tax settings from around the world, the choice of countries to be examined may primarily be governed by an objective of maximising diversity.
- In the case of the taxation of highly mobile factors of production, comparator countries may be selected on the basis of their relevance to the home country's capital flows (or flows of skilled labour), either as sources of capital (or skilled labour) or competitors for capital (or skilled labour).
- Where the purpose is to compare taxation arrangements against countries that have a close economic connection with Australia, the choice of countries may be determined by investment and trade links.
- Where the purpose is to investigate alternative settings for specific taxation parameters, or to benchmark existing parameters against those in other countries, the choice of country may be driven by similarity.

Regardless of the nature of any particular study, the social and institutional context of the tax system in each comparison country will be relevant in relating any findings back to the home country. The revenue requirements of the tax system will be determined, to varying extents, by the service and income redistribution functions of the government.

Societies' preferences may also bear directly on the design of the tax system by, for example, being reflected in the progressivity of the personal income tax system and the relative importance of different tax bases. Comparisons between countries in which the role of the public sector is significantly different may not be particularly informative, especially where the key purpose of the comparison is to benchmark tax settings against those in other countries.

1.3.2 Choosing the OECD-10 comparator countries

As noted earlier, comparisons of countries' taxation regimes should primarily be guided by the nature of the study. However, as a general benchmark, there is merit in comparing Australia's tax settings with those in countries that are broadly similar in terms of their overall tax burden and the role of the government sector in the economy. This is likely to be particularly relevant when comparing personal income tax settings, given the relative importance of individual taxation in the revenue base of most countries.

The proportions of revenue and expenditure to GDP are useful measures for identifying comparison countries. The revenue ratio is useful in identifying countries with tax systems designed to deliver broadly equivalent levels of revenue. The ratio of expenditure to GDP is a broad indicator for the size and role of government in the economy. There is no simple test for selecting countries using these ratios. The threshold for selecting comparator countries for this study was a pragmatic one, aimed at achieving a balance between the degree of conformity and a sufficiently large sample of countries to provide meaningful comparisons without overloading the study with excessive information.

Table 1.1 shows average revenue and expenditure ratios for a range of OECD countries for the four-year period 2000-2004. The eight highlighted countries have an absolute difference on revenue and expenditure of less than six percentage points, compared to Australia.

Table 1.1: Revenue and expenditure as a proportion of GDP[(a)]
Difference compared with Australia, averages for 2000-2004

	Revenue	Expenditure
Austria	13.0	14.4
Belgium	12.5	12.6
Canada	5.2	4.7
Czech Republic	3.4	10.1
Denmark	19.2	18.5
Finland	17.2	13.4
France	13.0	16.2
Germany	7.9	10.9
Greece	8.1	14.0
Hungary	7.5	13.3
Iceland	8.7	9.1
Ireland	-2.3	-3.3
Italy	9.2	12.2
Japan	-5.9	1.6
Korea	-6.4	-9.2
Luxembourg	8.4	6.0
Netherlands	7.9	9.4
New Zealand	4.4	1.2
Norway	20.8	9.7
Poland	4.8	8.8
Portugal	5.3	8.9
Slovak Republic	0.3	7.4
Spain	1.5	2.3
Sweden	22.7	21.4
Switzerland	-1.0	-0.7
United Kingdom	4.0	5.2
United States	-3.4	-0.5

(a) Data for Mexico and Turkey were not available.
Source: OECD *Economic Outlook* No. 78, 2005.

The Netherlands was chosen as the final comparator country. Of the countries with an absolute difference greater than six percentage points but less than ten percentage points (Iceland, Korea, Luxembourg, the Netherlands, Poland, Portugal and the Slovak Republic), the Netherlands and Korea have the closest economic connection with Australia. Of those seven countries:

- the Netherlands has the highest bilateral direct investment flow (inbound and outbound) with Australia and also has a similar size economy; and
- Korea has the highest bilateral trade flows with Australia.

On balance, the Netherlands was chosen partly because of its interesting approach to taxing capital income (taxing the imputed return).

This group of OECD countries is referred to throughout the report as the 'OECD-10' comparator group of countries. It consists of Australia, Canada, Ireland, Japan, the Netherlands, New Zealand, Spain, Switzerland, the United Kingdom and the United States.

The terminology is generally used even when data is not available on one or two countries (these exceptions are explained in the chapter or graph notes).

1.3.3 The selected Asian economies

Information on the tax burden and tax mix across ASEAN economies is included in this report. In addition, more detailed information was gathered on a smaller group of Asian

economies. Singapore and Malaysia were chosen because they are members of ASEAN. Hong Kong (SAR) was chosen because along with Singapore it is often cited as being a competitor with Australia for regional headquarters, and because it is an important destination along with Singapore and Malaysia for skilled Australians moving overseas on a permanent or long-term basis. Taiwan was chosen, notwithstanding data limitations, because it is an important regional economy and is a significant trading partner with Australia.

1.4 THE REPORT METHODOLOGY

This report is a combination of:

- descriptive and statistical information on overseas and Australian taxation arrangements;
- analysis and observations based on that information;
- information and analysis drawn from the OECD and other sources of technical expertise; and
- economic principles applied to taxation issues where relevant.

The OECD provides unweighted averages for many data series. Where there are sufficient countries analysed in this report, weighted averages have also been calculated. For a description of weighted and unweighted averages refer to Box 3.1.

1.4.1 Information collection

A major task of the study was to collect descriptive information about the important characteristics of the tax systems of the selected countries.

This report is based on a mixture of publicly available data and information sourced by the Australian Treasury from particular countries, and material in relation to business and personal tax rules in other countries sourced from four major tax advisory groups — Deloitte, Ernst & Young, KPMG and PricewaterhouseCoopers — as well as information from the Institute of Actuaries of Australia on the taxation of retirement savings. The four firms and the institute received no payment for the provision of this information.

Other sources of information about tax systems included:

- CCH Master Tax Guides for Australia, Canada, Hong Kong, Singapore, Malaysia, the United Kingdom, the United States, and New Zealand;
- International Bureau of Fiscal Documentation website;
- OECD Tax Database and OECD publications, including *Revenue Statistics* and *Taxing Wages*, and certain unpublished OECD studies (see references);
- various countries' revenue authority websites and governments' guides to their taxation systems;

- personal communications with OECD officials, taxation officials in other countries or with taxation experts; and
- various academic studies and published texts (see references sections for each chapter for a full list of information sources).

In some circumstances, for instance when comparing broad tax burdens where OECD information was available on all 30 OECD countries, the report has included that information. In other circumstances, where detailed taxation information needed to be collected, the report focused on the OECD-10 countries. The report has also included a discussion of some interesting features, such as the flat tax systems in Eastern Europe, of the taxation systems applying in countries including non-OECD countries.

In graphs data are generally shown in an ascending order.

The terms of reference requested the study to cover non-tax revenues where relevant and possible. Lack of comparable data limited the amount of analysis included in this report. Where total revenue is discussed in Chapter 2 and Chapter 12, it includes non-tax revenue.

1.4.2 Summary of methodology

The role of taxes in public finance

The public finance chapter includes the concepts of general government expenditure and revenue as a proportion of GDP. Taken together, these measures comprise the fiscal position of the general government sector. The fiscal balance is general government revenue less expenditure. The general government sector aggregates all levels of government for a country.

A statistical overview

The statistical comparison chapter focuses on the OECD-30. It presents the concept of taxation revenue as a proportion of GDP. This measure is the main indicator of tax burden used throughout the report. It is used in respect of aggregate tax burden and also for reporting the relative levels of tax burden for individual taxes.

Other measures that are used to inform the understanding of the tax burden are:

- tax per capita, which is total taxation revenue converted to Australian dollars using purchasing power parities and divided by population;
- effective tax rates, which is the revenue from a particular tax divided by a measure of the relevant tax base; and
- tax burden share by level of government.

Some of these concepts are also discussed in detail in respect of corporate taxation in Appendix 5.6.

A second concept presented in the chapter is that of tax mix. This measure refers to the composition of the tax burden — that is, the proportion of tax burden which is contributed by different types of taxes. In some cases the tax mix will be shown as components of the tax burdens of different countries, while in others it will be shown as a proportion of total revenue — that is, independent of the level of tax burden.

Wage and salary taxation

The wage and salary taxation chapter uses both aggregate measures and cameo analysis to provide an indication of Australia's personal tax burden. The most comprehensive measure used for the cameo analysis is the tax wedge, which takes into account personal income tax, employee and employer social security contributions, payroll taxes and cash benefits.

One of the issues in developing this chapter was the level of detail to provide on the tax wedge. Given the amount of information, summary results are is included in the chapter with more detailed charts and descriptions in the appendices.

The chapter includes a comparison of the top marginal tax rate and thresholds at which the top marginal tax rate is imposed for the OECD countries. The analysis was extended in Australia's case to take into consideration tax threshold changes due to take effect on 1 July 2006.

Measures of progressivity are also included in the analysis. These progressivity measures are based on an OECD methodology which calculates the change in the tax wedge for different income levels.

Corporate taxation

The corporate taxation chapter compares the corporate tax burden using several measures and notes the advantages and disadvantages of these measures. There is also a comparison of Australia's effective corporate tax rate (that is, tax paid as a proportion of the tax base) through time. Issues of data consistency prevented a wider comparison with effective tax rates for other countries.

The chapter also compares statutory corporate tax rates and bases, including historical changes, and draws further insights from the descriptive comparative tables on corporate tax rates, depreciation, losses, and key business tax concessions.

There is a comparison of effective tax rate measures for hypothetical investments, where those investments earn either a normal or a super-normal profit. A discussion of this effective tax rate methodology is provided in Appendix 5.6.

There is also a discussion of the taxation of corporate capital gains including a comparison of the corporate capital gains tax rate applying to the sale of a qualifying (substantial) shareholding.

Capital income taxation

The analysis of the taxation of capital income earned by individuals focuses on dividends, capital gains on shares and interest income. In most cases the analysis is based on OECD estimates of the top overall tax rate applying to capital income.

The first section covers the taxation of dividend income, which includes a discussion on systems for integrating the personal and corporate income tax systems. This is followed by a comparison of capital gains taxes on shares and the taxation of interest. The chapter concludes with a comparison of differences between personal and corporate income tax rates.

Retirement savings taxation

There are significant impediments to comparing the taxation of retirement savings across countries. There are no international sources of data isolating the taxation of retirement savings. Further, retirement income arrangements are broad and varied, and can include significant reliance on public provision — and, conversely, little reliance on private savings arrangements.

The chapter focuses on the taxation arrangements applying to private retirement savings. As retirement savings can be taxed at three points (on contributions, earnings and benefits), the chapter attempts to draw out measures of overall concessionality in the taxation of retirement savings.

Conclusions are drawn about the concessionality of arrangements within a country (compared to benchmark savings). A brief examination of revenue forgone is also explored. The results of the revenue forgone analysis underpin the conclusions about the relative internal concessionality of retirement savings taxation arrangements.

Finally, the limits imposed on the concessionality of retirement savings arrangements (both at contributions and benefits stages) are examined in a detailed table.

Taxation of goods and services

The goods and services taxes classification covers a broad range of taxes. When the aggregate information is broken down further, classification errors can arise. The chapter focuses on the broad classifications of general consumption taxes, and excise and customs duties combined.

Most of the analysis in this chapter is based around descriptive measurements of variations in tax rates and bases. Differences in the rate and base of general consumption taxes are explored and the rates of specific taxes levied on fuels are also compared.

The chapter also contains descriptive information on excise duty rates applied to alcohol and tobacco products. The diversity and complexity across countries in implementation and design of these duties make it difficult to determine Australia's relative ranking compared to other countries.

Property and transaction taxation

A wide variety of taxes fall into the property and transaction taxes category and there is considerable diversity between countries in the implementation and design of these taxes. This chapter discusses the relative ranking of Australia's property and transaction tax burden with the other OECD-10 countries over four sub-categories: taxes on immovable property; taxes on net wealth; estate, inheritance and gift taxes; and taxes on financial and capital transactions. Descriptive information on tax rates and bases is included for a selection of taxes that fall under these categories.

International taxation arrangements

The chapter explains that a country's international taxation arrangements are generally modifications to its domestic income tax system where cross-border investments and transactions are involved. Typical areas in which modifications occur are compared across the OECD-10 including the way in which foreign source income and the income of non-residents is taxed. International tax integrity rules and tax treaties are also compared.

Taxation and labour and capital flows

The chapter examines briefly Australia's cross-border skilled labour and capital flows including in the context of tax. It also looks at the experience of Ireland and the emerging major markets of China and India.

Selected Asian economies

The Asian economies chapter faced some significant issues including data availability. Where data was available there were concerns about its quality. Unlike OECD countries, where a central body exists to issue direction about how taxes are to be classified and reported, much of the available data appears to be what the particular country has determined should be reported, which leads to inconsistencies. These inconsistencies make it difficult to draw conclusions about differences in their approaches to taxation.

Some simple charts of tax mix and tax to GDP ratios are provided, but the chapter focuses on detailed descriptive examinations of particular aspects of the taxation regimes in place in various Asian economies.

Administration and compliance costs of taxation

The chapter discusses operating costs and highlights some of the difficulties in making international comparisons. Because of the difficulties, no summary is made of the various studies that estimate operating costs across countries.

Tax expenditures

As a result of difficulties in comparing estimates of tax expenditure across countries, comparisons were not attempted. The chapter explains the role of tax expenditures as a policy instrument and provides a brief discussion of the advantages and disadvantages of using tax expenditures as opposed to direct expenditure.

This is followed by a discussion of the various approaches that can be used to measure tax expenditures, highlighting the limitations in making comparisons. The chapter concludes with a comparison of tax expenditure reporting across the OECD.

1.5 LIMITATIONS AND CAVEATS

The study had to confront numerous limitations, which make it necessary to provide several caveats. In each of the detailed chapters, where appropriate, there is a discussion of the limitations of the particular measures or methodologies used in that chapter.

1.5.1 General caveat and legal limitation

Background information for the report was collected to support the work of the co-authors of the study.

The information included is not designed to constitute the basis for commercial decisions by individuals as it does not take into account the circumstances of any particular case. Separate financial and legal advice should be obtained for decisions on any private commercial matters.

1.5.2 Up-to-date information

Although the study sought the most contemporary information available about the taxation arrangements in other countries, there may be instances where the information is not current at the time of the release of the report. The report also had to manage the differences in data availability across countries with some countries having more contemporary data than others. Given these circumstances, some comparisons are based on earlier data to provide a common benchmark across the comparator countries.

1.5.3 Measures and averages

The study had to assess the merits of using particular measures and whether to use weighted or unweighted averages. Weighted averages have only been included in respect of the whole 30 OECD countries, and not for the OECD-10 comparator countries. An overview of weighted or unweighted averages is provided in Box 3.1.

1.5.4 Differing definitions of income

The differing definitions of income in some countries create issues for international comparisons.

One contrast is between the United States and Anglophone countries outside the United States (that is, Australia, Canada, New Zealand and similar countries). In the latter, a distinction is drawn between the judicial concept 'income', often referred to as 'ordinary income', and capital receipts (including capital gains). By contrast, in the United States the judicial concept of income is broad and does not make any distinction between 'ordinary

income' and 'capital gains' — income is synonymous with gain of any sort, including windfalls.

1.5.5 Broad legislation versus administrative practice

Even where countries' tax systems exhibit significant similarities at the broad design level, there may be differences in the detail of the law or its administration which make these similarities more apparent than real. Minor differences may create significant incentives to modify behaviour. A balance needs to be struck between the level of detail explored and the confidence that can be attributed to the accuracy of the comparisons.

1.5.6 Differing fiscal years

The fiscal year varies from country to country and this may have some effect on the comparisons. There is considerable variation in fiscal years among the OECD countries, for example:

- Australia — 1 July to 30 June;
- Canada — 1 April to 31 March;
- Ireland — calendar year;
- United Kingdom — 6 April to 5 April; and
- United States — 1 October to 30 September.

National authorities whose fiscal years do not match to the calendar year, provide data for OECD publications on a calendar year basis, where possible, to permit maximum comparability with the data of other countries.

There remain a few countries, including Australia, where data refer to fiscal years. For *Revenue Statistics 2005*, Australia provides 2003-04 data for the calendar year 2003.

Chapter 2

The role of taxation in public finance

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2. THE ROLE OF TAXATION IN PUBLIC FINANCE

SUMMARY

Communities face important choices about how particular goods and services should be provided. In broad terms, these choices can be private provision, regulation, or government provision. The choices have significant impacts on measures of the size of government expenditure or government revenue.

This report follows long-standing practices used by international organisations when making cross-country comparisons.

In 2003, Australia had the third lowest government expenditure as a proportion of GDP of 28 OECD countries (Mexico and Turkey do not provide comparable data) and the second lowest of the OECD-10.

The primary reason that Australia was the third lowest spending, yet eighth lowest taxing OECD country, is that many of the higher spending countries were running fiscal deficits in 2003.

The unweighted average fiscal deficit across the 28 OECD countries was 1.9 per cent of GDP. As the two largest economies in the OECD (the United States and Japan) have large fiscal deficits, the weighted average fiscal deficit in the OECD was 4.0 per cent of GDP.

2.1 INTRODUCTION

This chapter discusses the choices faced by governments and people about how to organise and manage key elements of their society and the economy. These choices are divided into three major categories for the purposes of discussion in this chapter — private provision, government regulation, and government expenditure programs funded by taxation revenue.

One of the three choices is to use government expenditure programs to deliver services funded primarily through taxation revenue. The chapter will outline the links between government expenditure and revenue, and some principles involved when considering tax policy design.

2.2 COMMUNITY EXPECTATIONS OF THE ROLE FOR GOVERNMENT

In liberal democratic societies, the community makes choices about how they want their society and economy to operate. One of the most fundamental choices is the balance between private and public provision of services.

Governments have a role in establishing elements of the framework which allow people to make choices. The minimal list of these usually include elements such as the establishment of the rule of law to protect the security of individuals, and the establishment of property rights, as well as the creation of legal systems for enforcement of agreements between parties.

Beyond this basic framework, communities may have very different expectations about what is best left for individual decision-making through private markets and private institutions, whether it is more appropriate for governments to require certain types of behaviour (for instance, wearing of seat belts), or whether governments should directly provide such services, either with payment or without.

2.2.1 Private provision

Communities may decide that many goods and services should be provided through private means including through private markets. Beyond the creation of the basic framework required to allow societies to operate (such as the rule of law), these market choices are fundamentally voluntary, private decisions. Much of the drive in recent decades in Australia towards freeing up markets is a belief that individuals are generally best placed to decide what is best for themselves.

The public/private balance and views on the role of government also extends into a broad range of social issues. There are debates in many societies about the appropriate roles, obligations and responsibilities within and between individuals, families and government.

Societies which choose high levels of private provision will have low levels of government expenditure and revenue. Individuals would still need to consider whether to purchase health insurance or self-insure if there were few public hospitals, or whether to accumulate a high proportion of their wages into private savings if there was no government support for the unemployed or the elderly. The potential for self-provision of such services should be considered when making comparisons between countries with very different balances between private, regulatory and government provision. Such issues are not pursued in this report.

2.2.2 Regulation

Another approach that communities can use to deliver social and other policy objectives is to mandate or regulate certain behaviour. Regulation is often used to achieve the community's social, environmental and economic objectives. It is typically used to set benchmarks for corporate governance and behaviour; ensure community safety and security; and to set standards and rules in relation to environmental objectives. The use of minimum wage laws in Australia is an example of an economic regulation that has an important impact on both individuals and businesses.

Box 2.1: Australia's Superannuation Guarantee

Discussions have occurred in the Australian community and through the press as to whether the Superannuation Guarantee (SG) payment is classed as a tax and should be included as such in this study.

The first point to note is that, under the OECD definition (as well as the IMF and World Bank), the SG would definitely not be classified as a tax. The definition used by the OECD and others is based around any such tax being an unrequited transfer to government and the SG does not fall into this category. The funds do not go to the government but are owned directly by individuals to be used or invested by the individual as he/she sees fit within the limits imposed by the private superannuation fund. Even at death, the balance of any funds are then owned by the individual's family or nominated beneficiaries.

In defining a total reward package to individuals, most businesses in Australia include SG, along with base salary plus any incentives, as part of that total salary package.

Right through this review, the authors have been willing to test the validity of a strict OECD definition if it was considered that some variation gave a clearer or better comparison. In this instance, there is an arguable proposition that SG is a mandated impost on employers and thus compares to the social security charges, which are also a mandated impost, and are included in the OECD figures (and definitions) as a tax. Where these social security charges differ, however, from the Australian SG is that these social security charges go to the government and are then distributed to individuals as some form of social security, but they do not necessarily equate to the original impost, nor do any equivalent balances revert to an individual's family or beneficiaries.

If, however, the authors elected, for the sake of comparison, to add the SG to existing figures two major problems are encountered in making a proper benchmarking comparison.

First, if the SG was added to the figures in this study, we should then, for proper comparison, adjust the comparator countries with similar regulatory requirements which are imposed, but which currently are not included (by OECD definition) in these countries' figures because they are not defined by the OECD as taxes (for instance, the compulsory Swiss health insurance requirement and the Netherlands 'mandatory' private savings arrangement). To add one non-defined set of figures to one country without adding similar non-defined figures to the other countries, would not allow a true benchmarking comparison.

Secondly, we do not have a clear figure for the 'impost' of the Australian SG which we should add. Some proportion of these payments would have otherwise accorded with voluntary decisions by people to provide for their retirement. Over 50 per cent of full-time Australian employees were already receiving superannuation contributions prior to the introduction of the SG. Putting money into superannuation is a very effective investment. The voluntary element (or what would have happened anyway) should be taken out of any definition of this 'impost'.

Box 2.1: Australia's Superannuation Guarantee (continued)

If it were possible to calculate and add the appropriate figures to both Australia and the comparator countries, it is uncertain if Australia's relative position based on this calculation would change.

Therefore to allow consistent comparison throughout this report, and given the uncertainty about whether it would make any overall difference to relative positions anyway, we have elected to follow the clearly defined OECD definition of tax classification.

Many societies use regulations to promote the provision of various forms of life and health insurance, as well as the provision of certain income support measures. In these situations, governments may not be directly involved in any of the related financial flows that the regulation imposes. Governments can still achieve social policy objectives that would otherwise be supported or delivered by either private choices or by the government. An example of regulation in Australia which requires some form of levy or transfer from employees to other private individuals is the enforcement of child support payments. Other examples of regulatory requirements are minimum wage laws, occupational health and safety regulation and environmental regulations.

There are other situations where regulations can also improve public outcomes. Examples include where there are information failures or demonstrated myopic behaviour. The presence of externalities may also indicate that some form of pricing or regulatory approach may be desirable. When considering such regulatory responses, the potential benefits should be weighed against the costs that regulation places on businesses, consumers, governments and the wider community. These costs flow not only from compliance costs, but also from the fact that regulation causes businesses to adjust their activities in ways that distort market outcomes, and may make some activities unviable and some previously unviable activities viable. These potential impacts highlight the importance of well-designed regulation.

In many cases, communities can choose between government regulation and public provision. Communities which rely to a greater extent on regulation will have lower reported expenditure and taxation levels in international comparisons.

2.2.3 Government provision

Communities may decide that they want particular activities not only regulated by government, but actually provided by government. Some goods and services are generally considered as best provided by government (a minimal list would include defence and foreign affairs). Other areas of government provision are debated more extensively, such as the appropriate degree of government involvement in the provision of health care or education. Taxation revenue is used to finance such government expenditure.

The OECD defines a tax as a compulsory, unrequited transfer to the general government sector. This definition is based on a system of national accounts reporting adopted by member governments over the last half century. Taxes are unrequited in the sense that the benefits provided by government to taxpayers are not necessarily in proportion to their contribution.

The key characteristics of this definition of a tax are that, to qualify as a tax, payments must be both compulsory and an unrequited transfer to government. If only the first condition is met, it is not a tax and therefore falls into the category of regulation outlined above.

These arrangements are summarised in a stylised way in Table 2.1, which shows the classification based on whether an action is voluntary or compulsory and whether any funds go to private individuals/institutions or to government.

Table 2.1: Classification of financial transfers

	Financial transfers from the private sector	
	To the private sector	To the government sector
Voluntary transfer	Private	Non-taxation revenue
Compulsory transfer	Regulation	Taxation revenue

At a more detailed level, non-taxation revenue can include a series of user fees, charges or fines related to the provision of a government service (for example, passport fees) and various types of royalty payments to government for the use of natural resources.

The remainder of this chapter, consistent with the terms of reference, will consider government expenditure and revenue issues.

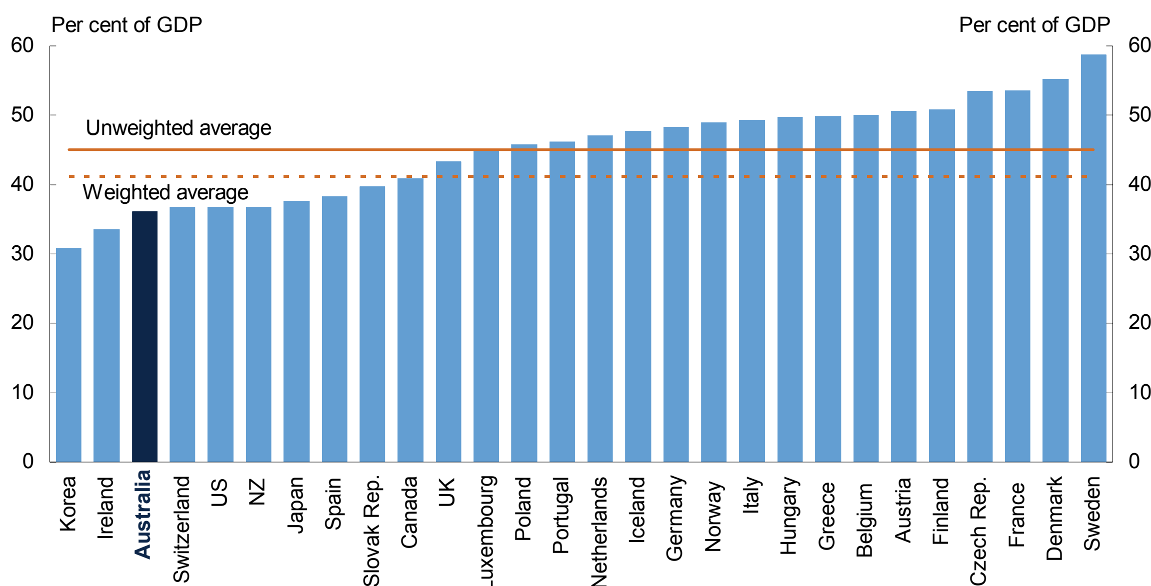
2.3 GOVERNMENT EXPENDITURE

The major differentiating factor between the tax burden in different countries over time is the amount of expenditure on government programs which each country's citizens demand. Financing this expenditure is, after all, the primary purpose of taxation.

As explained in Chapter 1, the approach in this report has been to compare Australia to developed countries (the OECD-30). The report also covers a group of countries with similar expectations regarding government provision of goods and services, as measured by government expenditure or revenue as a proportion of GDP (the OECD-10).

Australia has historically had relatively low government expenditure. In 2003, Australia had the third lowest government expenditure as a proportion of GDP of the 28 OECD countries with available information and the second lowest of the OECD-10 (Chart 2.1).

Chart 2.1: General government expenditure
OECD-30, total government expenditure as a proportion of GDP, 2003



Source: OECD *Economic Outlook* No. 78, 2005.

Government expenditures as a proportion of GDP are higher in developed countries, including developed non-OECD countries in the Asian region, than they are in developing countries. Given that citizens in advanced industrial democracies tend to demand greater social expenditure by government, it should be expected that aggregate level comparisons would point to lower government expenditure, and lower taxation, in developing countries when compared with a developed country such as Australia. Specific examples of this are provided in Chapter 12.

2.4 THE OBJECTIVES OF TAXATION

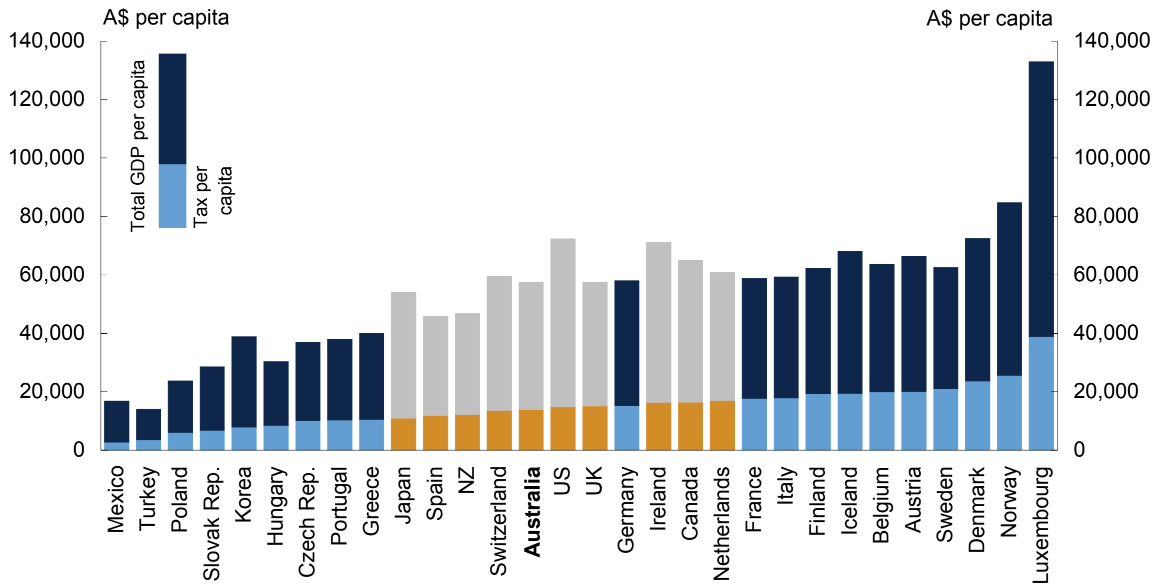
The fundamental purpose of taxation is to finance government expenditure. Beyond this primary purpose, modern tax systems are also guided by principles of efficiency, equity and simplicity. There are instances when these three principles conflict, and there are also instances when the principles conflict with the revenue raising purpose of taxation. Differences in public choice outcomes between countries reflect the different history and circumstances of each country, and there are many different approaches that can be taken to balancing the objectives of public policy.

The tax system can be used for purposes other than revenue raising. In certain situations, imposing a tax may potentially increase efficiency if markets fail to price factors such as pollution or congestion, or the health costs of particular types of behaviour such as cigarette smoking. Such costs external to the market mechanism are referred to as 'externalities'. Some OECD countries have imposed specific taxes in an attempt to use market prices (inclusive of the price-correcting tax) to allocate resources efficiently, taking into account some of these externalities.

The relationship between taxation revenues per capita and the level of GDP per capita are shown in Chart 2.2. As indicated in the chart, Australia collects less tax per capita than the United States. The reason the United States has a higher taxation revenue per capita than

Australia, but a lower taxation revenue as a proportion of GDP, is because it has higher levels of income. Similarly, New Zealand collects less tax per capita than Australia, but has a higher tax to GDP ratio, because Australian incomes are higher than in New Zealand. The chart also indicates the similarities with the OECD-10 grouping and Australia — in terms of tax per capita, ten of the comparator countries are within a band of 11 countries (Germany being the exception).

Chart 2.2: Tax per capita as a proportion of GDP per capita[(a)]
OECD-30 and OECD-10, 2003



(a) Calculated using OECD data and IMF purchasing power parities.
Source: Australian Treasury estimates.

2.5 ALTERNATIVE FISCAL POLICY POSITIONS

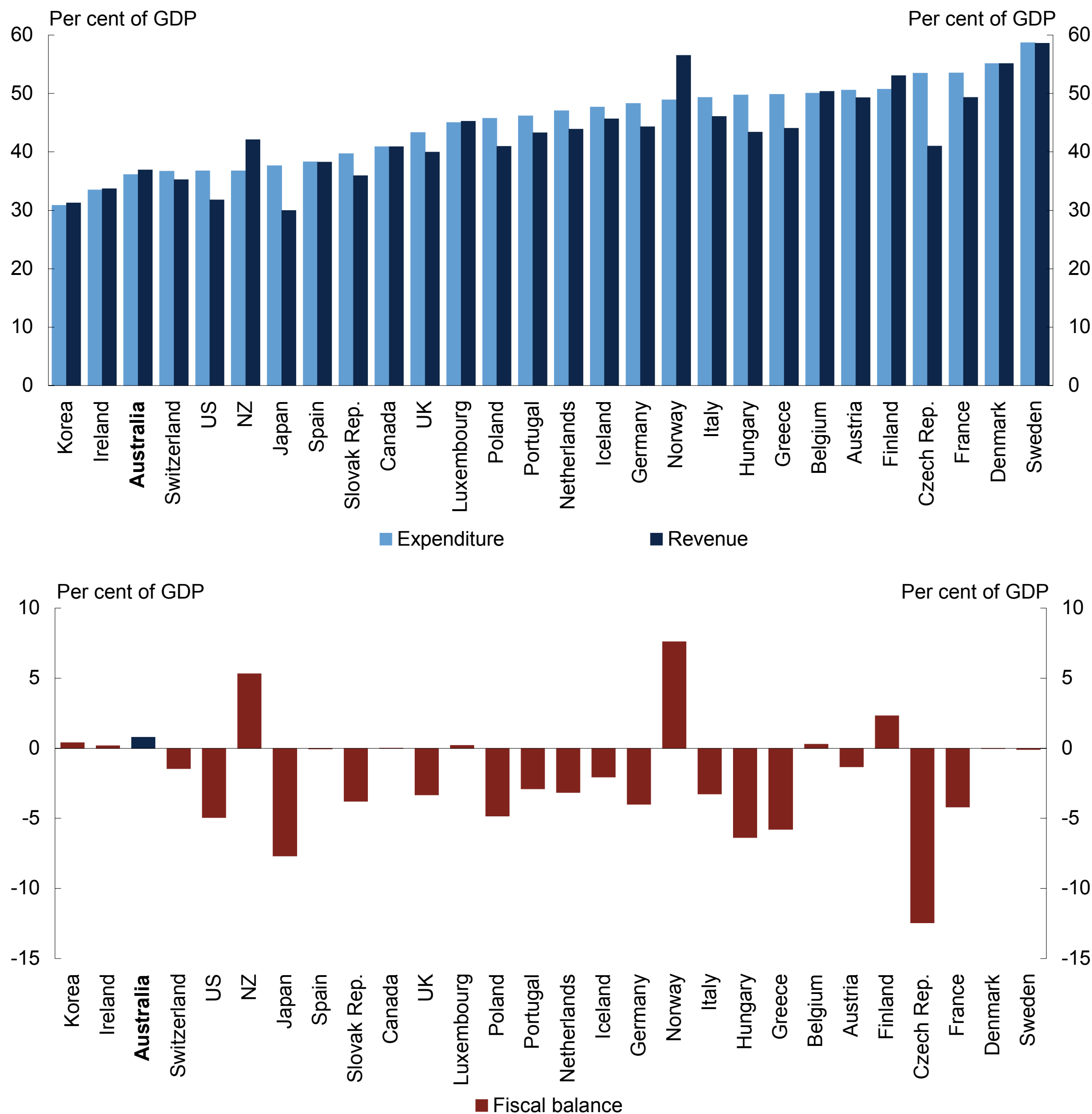
Different fiscal strategies between countries make simple comparisons of their tax burdens challenging. All governments have choices to make in terms of overall levels of expenditure and the taxation revenue necessary to finance that expenditure. The implications of any imbalances between expenditures and revenues over time are discussed in Box 2.2.

The report provides an overview of the fiscal position of different countries. It uses 2003 for making international comparisons as that is the latest year for which there was detailed taxation revenue data available for the OECD. In 2003, most OECD countries were running fiscal deficits. In contrast, Australia was one of nine countries with a fiscal surplus.

This difference in fiscal position is an important aspect of understanding Australia's relative tax burden. The primary reason that Australia in 2003 was the third lowest spending, yet eighth lowest taxing country, is that many of the higher spending countries were running fiscal deficits. The fiscal position for the 28 OECD countries is depicted in Chart 2.3. Comparable data is not available for Mexico or Turkey, so they are not shown in the chart.

Chart 2.3: Fiscal position of OECD-30

Expenditure, revenue and fiscal balance as a proportion of GDP, 2003

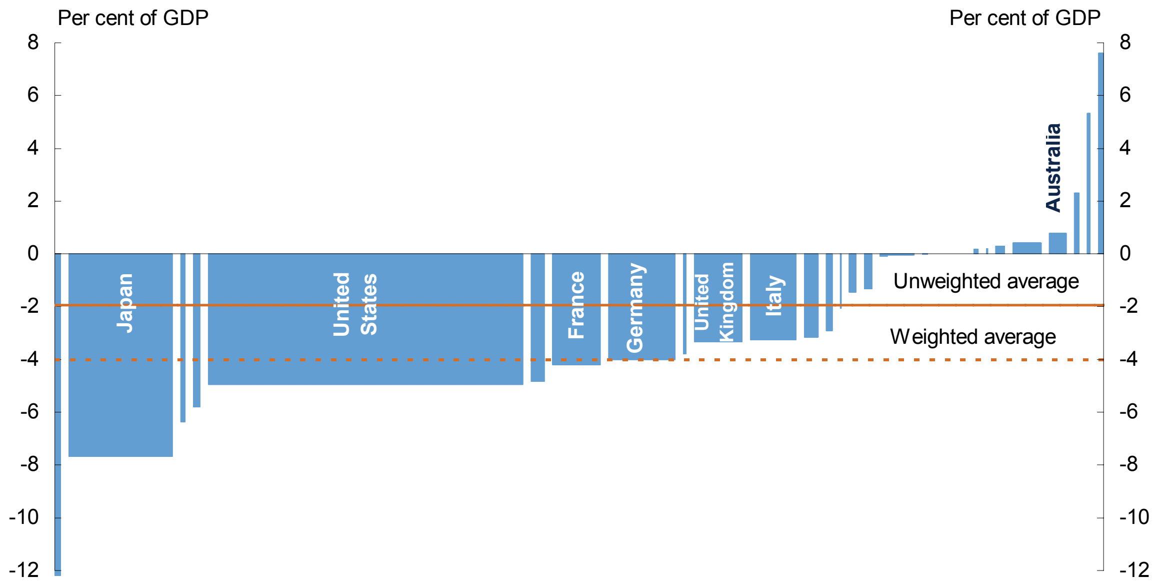


Source: OECD *Economic Outlook* No. 78, 2005.

The unweighted average fiscal balance of the 28 OECD countries was a deficit of 1.9 per cent of GDP. As the two largest OECD countries both have large fiscal deficits, the weighted average fiscal deficit is 4.0 per cent of GDP. An illustration of how the weighted average fiscal deficit is derived is provided in Chart 2.4.

Chart 2.4: Fiscal balances of OECD-30

Balance as a proportion of GDP, weighted by GDP at purchasing power parity[(a)], 2003



(a) Refer to Box 3.1 for a discussion of weighted and unweighted averages.
Source: Australian Treasury estimates.

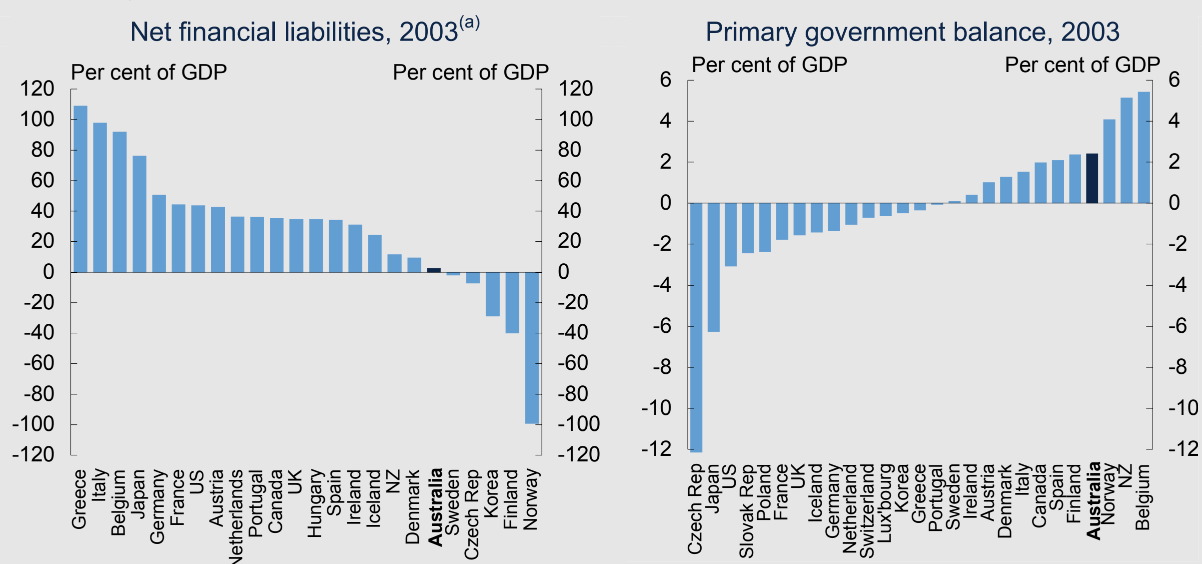
Box 2.2: The inter-temporal dimension of the tax burden

Tax burdens are difficult to compare internationally, even at the highest level of aggregation — total taxation revenue as a proportion of GDP. One area that causes particular difficulty is the inter-temporal dimension of the tax burden, or public finance more generally.

- Countries may choose to have lower tax burdens in the short run, without reducing their levels of expenditure, if they are willing to run budget deficits and accumulate government debt (or conversely, by reducing their holdings of assets).
- Countries with relatively large levels of government debt may need to have a higher tax burden in the future, or reduce expenditures relative to revenues, in order to finance that stock of debt or repay it. Periods of strong economic growth can also help to improve the fiscal position.
- Large fiscal imbalances or large levels of debt may not be sustainable for long periods, and choices may need to be made to reduce expenditures or increase revenues.

The charts below show that all countries are not in a similar fiscal position. Australia has a low level of government debt compared with most OECD countries and runs a fiscal surplus. Other countries with which Australia's tax burden is frequently compared have very different fiscal positions.

- The United States and Japan are running substantial budget deficits and have significantly higher levels of government debt than does Australia. Consequently, it could be argued that their current levels of tax burden relative to Australia are understated from an inter-temporal perspective.
- In the future, the United States and Japan will need to revise their policy settings by reducing expenditures as a proportion of GDP, raising taxation as a proportion of GDP, or some combination of the two, in order to put their fiscal positions onto a more sustainable footing. Policies to boost their economic growth rates, where feasible, or sell public assets may also play a role in the longer term.
- Interestingly, Australia's very low level of public debt gives it greater future fiscal policy flexibility than most other OECD countries.



(a) It should also be recognised that there may be other liabilities that are not reflected. For example, Australia has significant levels of unfunded superannuation liabilities, which are not counted as government debt but have similar characteristics. The Australian Government is using its current strong fiscal position to provide funding for some of those liabilities through the Future Fund. However, other countries have even larger unfunded social security arrangements. Furthermore, the OECD notes that, in many countries, these social security arrangements have a persistent deficit requiring subsidies from general taxation.

Source: OECD *Economic Outlook* 78, 2005.

Chapter 3

A statistical overview

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3. A STATISTICAL OVERVIEW

SUMMARY

There are many different ways of comparing the taxation systems of different countries — from aggregate measures to measures that focus on individuals, levels of government or particular taxes. Each measure has strengths and weaknesses, and none may be definitive in its own right. Together they paint a picture of how taxation systems in different countries compare. They also need to be placed in the overall context of the countries being compared and not considered in isolation from broader economic issues.

This chapter provides a high level overview of these measures and how Australia's taxation system compares with that of other countries. Drawing largely on OECD data, these measures focus particularly on comparing broad categories of taxation revenue from a national accounting perspective.

- The data reported in this chapter combine taxation revenues from all levels of government — that is, national, provincial and local governments. Where practicable, information about the split between levels of government is also provided.

The broad conclusions from this comparison are as follows.

- Australia has a low tax burden, both currently and historically. In 2003, Australia had the eighth lowest tax burden of the OECD-30 countries and has typically ranked in the bottom third of countries for the period since 1965.

- Australia's tax burden as a proportion of GDP is 31.6 per cent. This is below the unweighted OECD-30 average of 36.3 per cent and above the GDP-weighted OECD-30 average of 30.9 per cent.

- Australia's tax mix is broadly consistent with other countries', although there are some distinguishing features. Like most other advanced countries, Australia raises the majority of its taxation revenue (60.9 per cent compared with the OECD-30 unweighted average of 62.2 per cent) from direct taxation levied on incomes and payrolls. The remaining 39.1 per cent of Australia's taxation revenue is derived from indirect taxation — including the goods and services tax, excise and customs duty, and property taxes.

- Australia's tax burden on individuals and payrolls (14.0 per cent of GDP) is significantly lower than the OECD-30 unweighted average (19.5 per cent) and the average of the OECD-10 countries (16.3 per cent). Ten OECD-30 countries, and three of the OECD-10, have revenues classified as taxation on payrolls and workforce.

- Australia has a relatively high company tax burden. It is the third highest at 5.3 per cent of GDP, compared with the OECD-30 unweighted average of 3.3 per cent and the average for the OECD-10 of 3.4 per cent. However, classification issues make it difficult to draw useful conclusions from these comparisons.

- Australia's tax mix has a significantly lower reliance on value added and sales taxes (4.3 per cent of GDP) than the OECD-30 unweighted average (6.8 per cent).

- Taken together, Australia raises around 3.4 per cent of GDP in excise and customs duties — in line with the OECD-30 average (3.4 per cent). However, there are several classification issues with customs duty which make it difficult to draw useful conclusions from the data.

- Australia has a relatively greater reliance on immovable property taxes (1.4 per cent of GDP) and transaction taxes (1.6 per cent) than the OECD-30 average (0.9 per cent and 0.6 per cent respectively). Transaction taxes are a significant revenue source for Australia's state governments.

3.1 THE TAX BURDEN

3.1.1 What is the tax burden?

The standard measure of the aggregate tax burden is total taxation revenue as a proportion of GDP. While not perfect, it is a universally adopted measure, including by the OECD. Difficulties with this measure include:

- in some cases, taxes are levied on bases that may not even be reflected in GDP (for example, capital gains tax on asset price increases and taxes on land values);

- measures of GDP are estimates and they are often revised, whereas taxation revenues have a reasonable degree of certainty;

- Australia has a full accrual accounting system for the collection and reporting of taxation revenues. This is different to most other countries, where the systems are predominantly cash or partial accrual accounting. This difference typically leads to a downward bias in the level of the reported tax burden of other countries, during periods of economic growth, because of the less than full recognition of tax liabilities recognised but not yet collected; and

- there are numerous differences and difficulties in standardising the classification of taxes and the components of GDP across countries.

Notwithstanding all of these issues, tax as a proportion of GDP remains the best and most widely accepted aggregate measure of the tax burden, and is the standard measure reported in this chapter, and throughout the report. Other measures of the tax burden are also noted in this report, where those measures provide supplementary information.

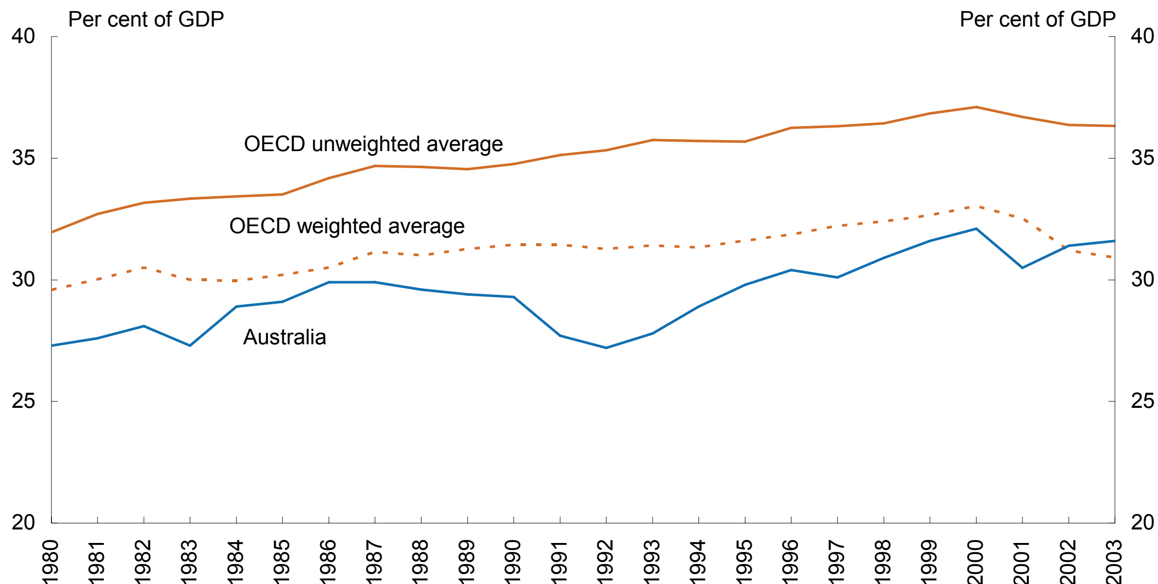
3.1.2 Comparing tax burdens

The Australian tax burden has followed the broad trend of growth displayed by most advanced countries, increasing from 27.3 per cent of GDP in 1980 to 31.6 per cent in 2003. The increased tax burden of most countries has been required to finance the increased

service levels provided by governments over this period. Australia's tax burden is relatively low, compared with most OECD countries.

Chart 3.1: The Australian tax burden in perspective

OECD-30, total taxation revenue as a proportion of GDP, 1980-2003



Source: OECD *Revenue Statistics*, 2005.

In 2003, Australia's tax burden (31.6 per cent) was lower than the OECD-30 unweighted average (36.3 per cent), and was around the same level as that of the OECD-10 comparator group of countries (32.0 per cent) and the weighted OECD-30 average (30.9 per cent).

- The OECD-30 weighted average is significantly lower than the OECD-30 unweighted average because the United States and Japan, which jointly contribute around half of total OECD GDP, have significantly lower tax burdens than most of the rest of the OECD.

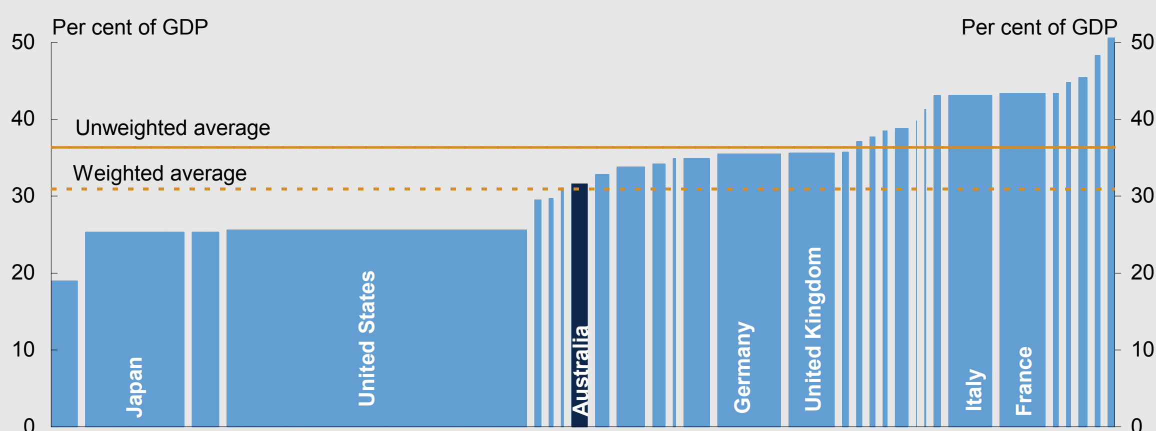
Since 2000, there has been an abrupt and large reversal of trend in the OECD-30 weighted average tax burden (Chart 3.1). This has mostly been driven by large reductions in taxation revenue in the United States and Japan.

In broad terms, the Australian tax burden has always been lower than the OECD-30 weighted average and significantly lower than the unweighted average. The sudden change in the tax burden of the United States and Japan means that, for the first time, the relative position of Australia's tax burden has changed from being below the OECD-30 weighted average to being slightly higher.

- Since 2000, the tax burden of the United States has been reduced by 4.3 percentage points, from 29.9 per cent of GDP to 25.6 per cent of GDP. In the same period, Japan's tax burden was reduced by 1.2 percentage points from 26.5 per cent to 25.3 per cent.

Box 3.1: The use of summary statistics: weighted and unweighted averages

Unweighted averages are the simple average of a range of observations. Only unweighted averages are reported in the OECD's Revenue Statistics — the source of most of the data used in this report. This means that each country's tax burden is given an equal weight in the average of all OECD countries' tax burden, regardless of whether that country is Australia, which in 2003 contributed 1.9 per cent of the total GDP of all OECD countries, or the United States, which contributed 36.3 per cent of total GDP.



In comparison, weighted averages scale the tax burden of each country by that country's contribution to total GDP. On this basis, the tax burden of the United States contributes 36.3 per cent of the average tax burden for the whole OECD, while the tax burden of Australia contributes 1.9 per cent of the average OECD tax burden.

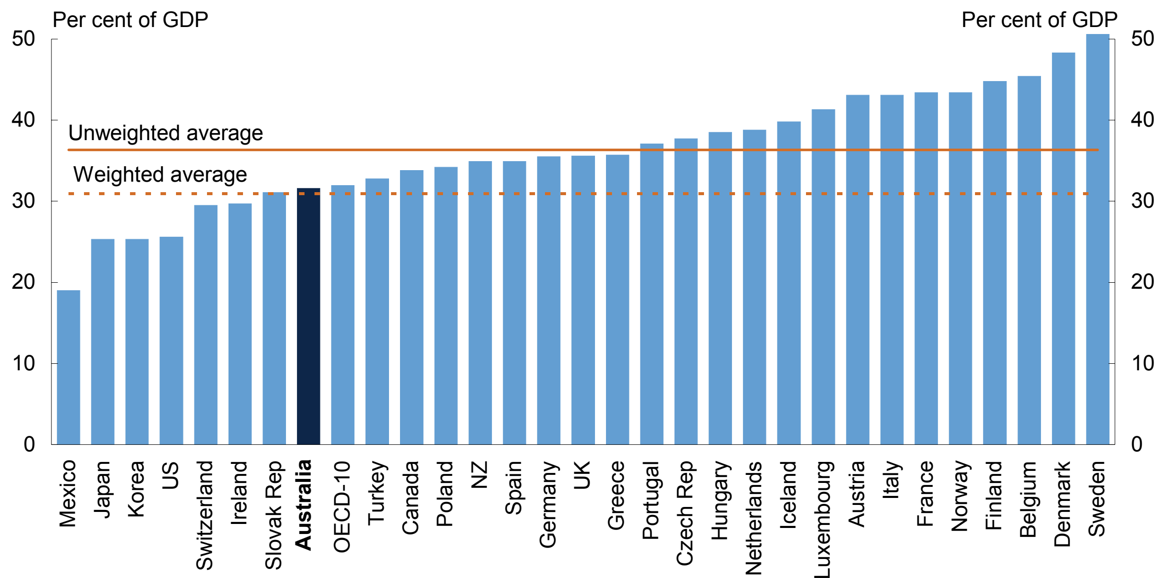
As with most summary statistics, the choice of statistic depends on how it is to be used. The OECD only uses unweighted averages in *Revenue Statistics*. Unweighted averages best reflect the diversity of experience in the OECD. In contrast, weighted averages may be useful if the observer wants to understand the proportion of economic activity relevant to a particular issue — for example, the rate of growth of OECD GDP is a weighted average.

Both weighted and unweighted averages of OECD countries are presented throughout this chapter, in part, because different readers will prefer to make comparisons using one statistic rather than the other. What this draws out is the difficultly in making definitive statements in international comparisons.

- If an observation for a country is above the weighted average, but below the unweighted average, does that make it 'average'?
- Where an observation for a country lies above or below both averages, there could be a range of other factors that need to be taken into account before drawing any conclusions. Differences in classification between countries is the most obvious, but by no means the only, factor that needs to be considered — for example, just because Mexico does not report any personal income tax does not mean that it does not tax personal incomes.

There are a range of other statistical measures of dispersion. For example, there are the median and standard deviation, but these are not used in this report. Instead, charts are the main presentation tool to assist the reader in understanding the varied experiences of OECD countries.

Chart 3.2: The tax burden
OECD-30, total taxation revenue as a proportion of GDP, 2003



Source: OECD *Revenue Statistics*, 2005.

The average tax burden for the European Union members of the OECD in 2003 was 39.4 per cent — well above the Australian tax burden. However, there is quite a diverse pattern of tax burden within the European Union.

- The Nordic (Sweden, Finland, Norway and Denmark) and European Lowland (Belgium, Luxembourg and the Netherlands) countries typically have higher tax burdens (Sweden had a tax burden of 50.6 per cent) and the Mediterranean and Eastern European countries typically have lower tax burdens (Turkey was 32.8 per cent). Switzerland has the lowest tax burden (29.5 per cent) of all the European Union members of the OECD.

Australia had the eighth lowest tax burden of the OECD-30 in 2003 (Chart 3.2). Of all the OECD countries, only Mexico, Korea, Japan and the United States have a significantly lower tax burden than Australia. Switzerland, Ireland and the Slovak Republic had a marginally lower tax burden than Australia in 2003.

For the period 1965 to 2003, Australia's tax burden has mostly been in the bottom third of OECD countries (Table 3.1). Australia's tax burden has typically been lower than that in most of the European countries, the United Kingdom, New Zealand and Canada, but has generally ranked above Japan and the United States.

Ireland is noteworthy. Its tax burden has been dropping rapidly over the last two decades. It ranked as the twelfth highest taxing OECD economy in 1985, yet by 2003 it had the sixth lowest tax burden. The Irish experience is discussed in greater detail in Box 11.1.

Table 3.1: Ranking of OECD countries in descending level of tax burden(a)
Selected years, 1965-2003

	1965	1970	1975	1980	1985	1990	1995	2000	2003
Sweden	1	2	1	1	1	1	2	1	**1**
Denmark	9	1	4	2	2	2	1	2	**2**
Belgium	6	5	3	5	3	4	4	4	**3**
Finland	7	10	7	10	9	3	3	3	**4**
France	2	8	9	7	7	6	5	5	**5**
Norway	10	6	5	4	5	7	10	6	**5**
Austria	3	7	8	8	8	9	10	8	**7**
Italy	14	16	18	15	13	10	9	6	**7**
Luxembourg	11	15	6	6	4	8	7	10	**9**
Iceland	12	13	13	16	17	17	21	11	**10**
Netherlands	4	4	2	3	6	5	8	9	**11**
Hungary							6	12	**12**
Czech Republic							12	17	**13**
Portugal	22	22	22	22	21	20	18	16	**14**
Greece	19	18	20	21	18	18	20	13	**15**
United Kingdom	7	3	10	11	10	12	17	14	**16**
Germany	5	9	10	9	11	14	13	15	**17**
Spain	23	23	23	23	20	16	22	19	**18**
New Zealand	17	17	15	14	15	11	15	21	**18**
Poland							14	22	**20**
Canada	13	11	12	13	14	13	16	18	**21**
Turkey	24	24	24	24	26	24	27	23	**22**
Australia	18	19	17	18	16	18	23	24	**23**
Slovak Republic								20	**24**
Ireland	15	12	14	12	12	15	19	24	**25**
Switzerland	20	19	16	17	22	23	25	26	**26**
United States	16	14	19	19	23	22	24	27	**27**
Japan	21	21	21	20	19	21	26	28	**28**
Korea			25	25	25	25	28	29	**28**
Mexico				26	24	26	29	30	**30**
Total countries	**24**	**24**	**25**	**26**	**26**	**26**	**29**	**30**	**30**

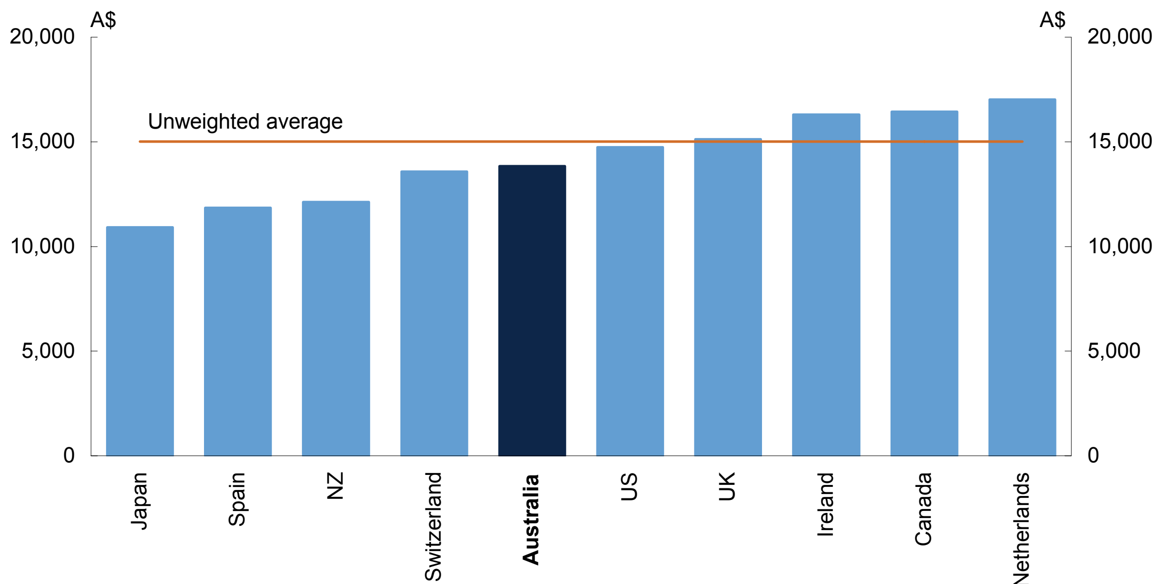
(a) Since 1965, the member countries of the OECD has increased from 24 to 30.
Source: OECD *Revenue Statistics*, 2005.

3.1.3 The tax burden per capita

As noted in section 3.1.1, the standard measure of the aggregate tax burden is total taxation revenue as a proportion of GDP. There are several other ways of thinking about a country's tax burden. For example, Chapter 4 provides details of the tax burden of typical types of taxpayers in different circumstances. These tax burdens are expressed in terms of either average or marginal rates of tax paid, or amounts of tax paid in Australian dollars.

Another aggregate measure of the tax burden is to calculate the average level of tax paid by the average person in Australian dollars. This measure is the tax burden per capita. The main deficiency with this measure of tax burden, particularly when compared with taxation revenue as a proportion of GDP, is that it does not account for capacity to pay or the ratio of taxpayers to non-taxpayers (for example, most children and various low income earners).

Chart 3.3: The tax burden per capita[a]
OECD-30, total taxation revenue per capita, 2003



(a) Calculated using OECD data and IMF purchasing power parities.
Source: Australian Treasury estimates.

On this basis, Australia has a low tax burden when measured as taxation revenue per capita (A$13,834) — slightly below the OECD-10 average of A$15,011. New Zealand ranks lower (A$12,122), and the United States (A$14,738), the United Kingdom (A$15,124) and Canada (A$16,436) are among those countries that rank higher (Chart 3.3).

One of the reasons the United States has a higher taxation revenue per capita than Australia, but a lower taxation revenue as a proportion of GDP, is because it produces more GDP per person than does Australia (this comparison was highlighted in Chapter 3 in respect of all the OECD countries). The higher productivity and higher income of the United States give it greater capacity to raise more taxes than Australia, while still potentially leaving its citizens with more disposable income than is the case for Australia.

3.1.4 Effective tax rates

While the statutory rate of tax is the *headline* rate of taxation for each dollar of income or consumption, the effective rate is the *average* rate of taxation for every dollar of income or consumption. It is the total tax obligation, including all relevant taxes and credits, divided by total income or consumption.

Unlike statutory rates, effective tax rates are not readily observable. Instead, researchers use various methods to measure representative effective tax rates. In making international comparisons, a country's international ranking can vary considerably depending on the effective tax rate measure adopted. Unfortunately, all effective tax rate measures have significant methodological and/or data problems.

There are several ways to calculate effective tax rates.

- Using tax return data, the effective tax rate reflects the tax payable as a proportion of total (rather than taxable) income or consumption. In this case, the effective tax rate can differ

from the statutory rate where taxable income differs from actual income — for example, because of tax offsets. This measure of the effective tax rate is likely to be inflated to some degree because non-compliance is likely to result in observed taxable income being lower than underlying taxable income.

- Hypothetical effective rates can be calculated using stylised modelling of investment, income or consumption. This method is often adopted by researchers, some of which are referred to in this report.
- Using aggregate national accounts data and taxation revenues, the effective tax rate reflects the proportion of taxation revenue to the relevant economic income base. In this case, the effective tax rate can differ from the statutory rate because the taxation revenue might include taxes levied on bases which may not be accurately included in the economic income (for example, capital gains), or because taxable income may differ from economic income — for example, this may be because rates of depreciation are higher or lower than economic depreciation.

Where effective tax rate measures use historical data, inadequate data may complicate the comparison of rates over time and between countries. Hence, robust estimates are not readily available.

Effective tax rates for Australia are reported in Chapter 4 in respect of personal income taxes and Chapter 5 in respect of company income taxes.

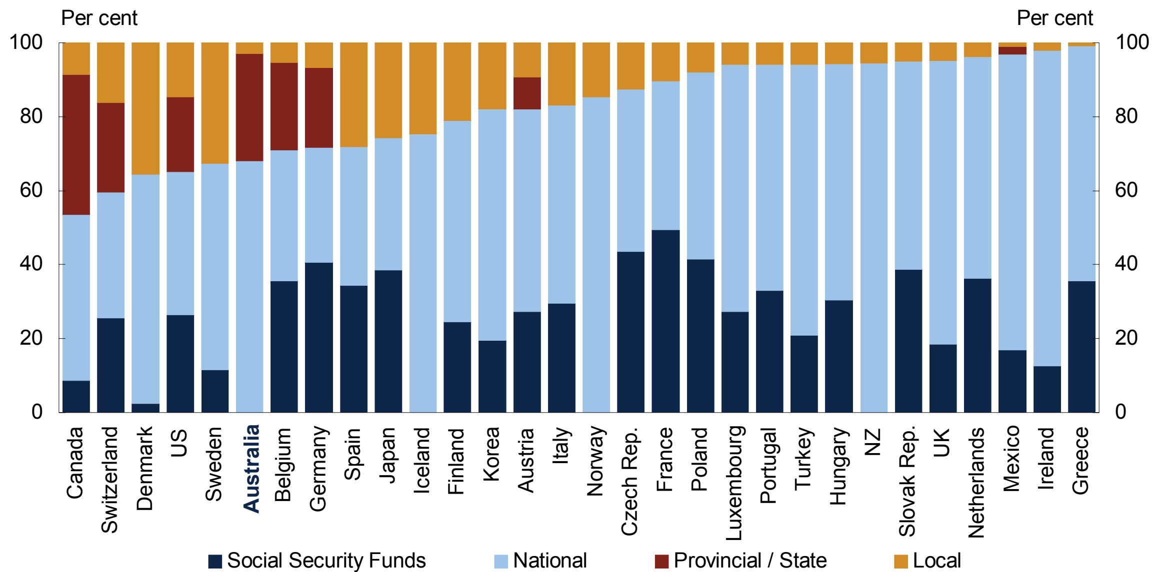
3.2 THE ROLE OF SUB-NATIONAL GOVERNMENTS IN TAXATION

Australia has three levels of government. The Commonwealth, State, Territory and local governments each have various powers to raise taxation revenue. Only a few other OECD countries have a federal structure — most notably the United States, Germany, Canada and Switzerland. The majority of OECD countries only have two levels of government — national and local.

The formation of the European Union as a supranational government means that some European countries now have four levels of government with taxing powers, although most have three levels. The tax burden of the European Union is relatively small — typically one percentage point or less of each country's national tax burden — and, for the purposes of the analysis in this report, it is treated as part of the national government tax burden.

Chart 3.4: The tax burden share by level of government[(a)]

OECD-30, as a proportion of total taxation revenue, 2003



(a) For a large number of countries, the OECD has not allocated a large proportion of social security contributions to any particular level of government. For the purpose of this analysis, these contributions have been assigned to the national government. Consequently, caution should be exercised in interpreting these data.
Source: Australian Treasury estimates.

In addition to these four levels of government, the OECD allocates part of taxation revenue to a fifth category titled 'Social Security Funds'. The breakdown across these five categories is shown in Chart 3.4, with details provided at Appendix 3.2. This fifth category creates difficulties for making international comparisons on the level of centralisation or decentralisation. No comprehensive data is available from the OECD on the distribution of social security tax across levels of government (information is provided for some countries on the allocation for government employees, but this comprises only a small proportion of total payments).

In the absence of reliable information on allocating these taxes, there is scope for considerable misrepresentation of this information. For instance, if all these social security funds were allocated to the national government, Australia would have the second highest level of state/provincial revenue raising of the eight federal countries in the OECD-30. If it was all allocated to the state/provincial level, then Australia would have the second lowest level.

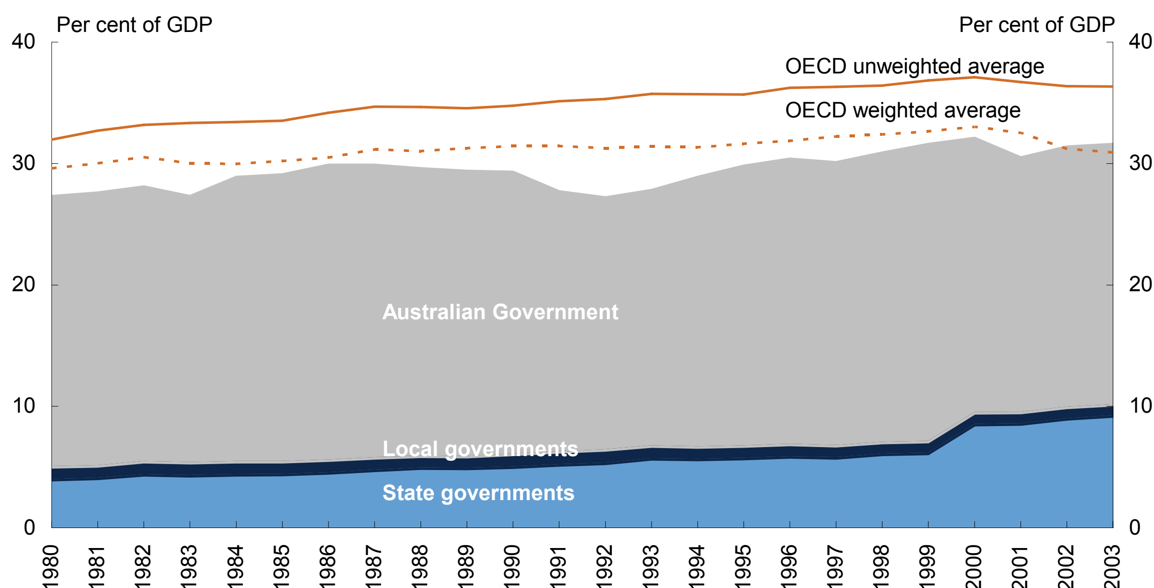
Given these difficulties, no ranking is provided on comparative measures of centralisation or decentralisation.

For information, some further data on the composition of taxation revenue collection across levels of government in Australia is provided in Chart 3.5.

The Australian Government raises 68.1 per cent of Australia's total tax burden, and State governments raise 29.0 per cent (Chart 3.5). Local governments' share has historically been around one per cent of GDP.

- Australia's goods and services tax is classified by the OECD as a state tax.

Chart 3.5: The Australian tax burden by government sector
Total taxation revenue as a proportion of GDP, 1980-2003



Source: OECD *Revenue Statistics*, 2005.

The tax burden of Australia's state governments increased from 6.1 per cent of GDP in 1999 to 8.5 per cent of GDP with the introduction of the goods and services tax in July 2000. The goods and services tax replaced a range of state government taxes and grants from the Australian Government. Since 2000 the tax burden of the State governments has increased by a further 8 per cent (or 0.7 percentage points), taking the State government tax burden to 9.2 per cent of GDP in 2003.

3.3 TAX MIX

3.3.1 Overview

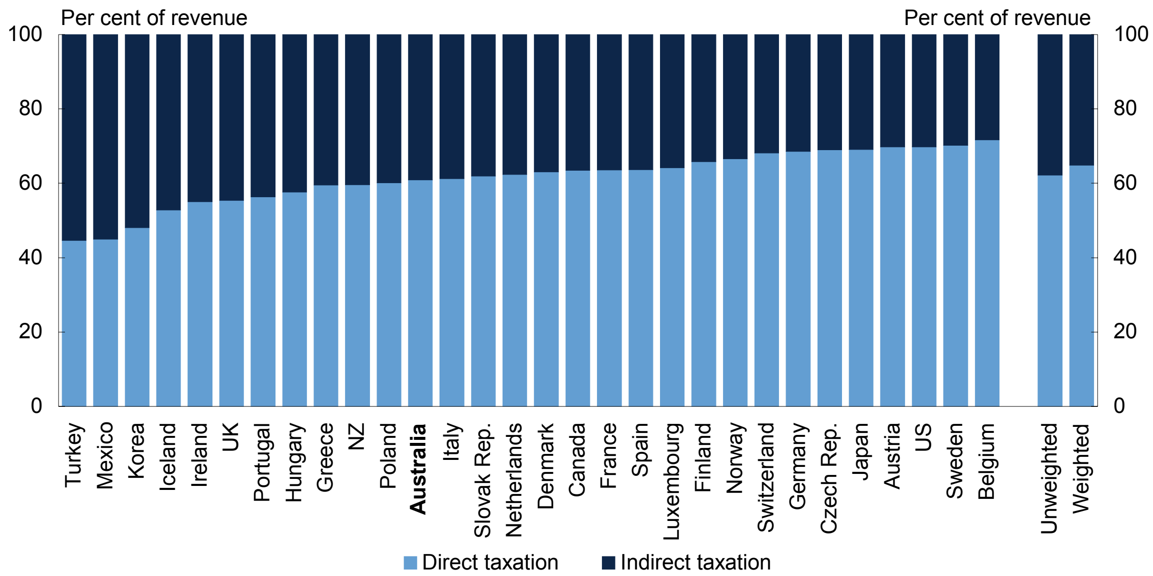
The Australian tax mix is broadly similar to most OECD countries, although there are a few distinguishing features (Chart 3.6).

Like most other advanced countries, Australia raises the majority of its taxation revenue (60.9 per cent in 2003) from direct taxation levied on incomes — wages, salaries and profits. The OECD-30 unweighted average is 62.2 per cent and the OECD-30 weighted average is 64.9 per cent. Japan (69.0 per cent) and the United States (69.8 per cent) have a higher reliance on direct taxation than Australia.

The remaining 39.1 per cent of Australia's taxation revenue is derived from indirect taxation — including the goods and services tax, excise and customs duty, and property taxes. The OECD-30 unweighted average is 37.8 per cent and the OECD-30 weighted average is 35.1 per cent.

Chart 3.6: Tax mix

OECD-30, direct and indirect taxation revenue as a proportion of total taxation revenue, 2003



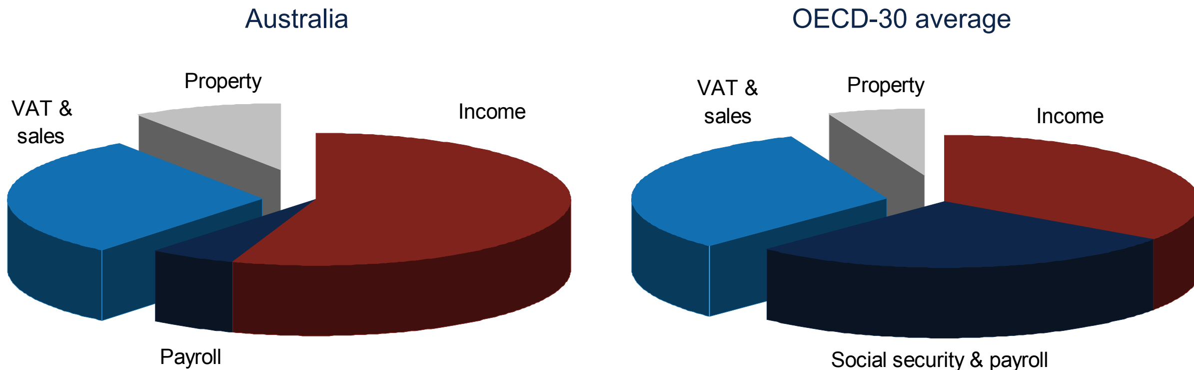
Source: OECD *Revenue Statistics*, 2005.

When income taxes, payroll taxes and social security contributions are taken together, the share of Australia's direct taxes in total taxation is broadly comparable with the OECD-30 average (Chart 3.7). For a significant number of countries, social security contributions are now the largest source of direct taxation revenue.

- Social security contributions are described in detail in Chapter 4. They usually consist of two components — one withheld from employees' wages and the other paid by employers. Both components are treated by the OECD as a tax on the income of individuals because they form part of an employee's remuneration.

Chart 3.7: Australia's tax mix compared with the OECD average

OECD-30, direct and indirect taxation revenue as a proportion of total taxation revenue, 2003



Source: OECD *Revenue Statistics*, 2005.

3.3.2 Direct taxation

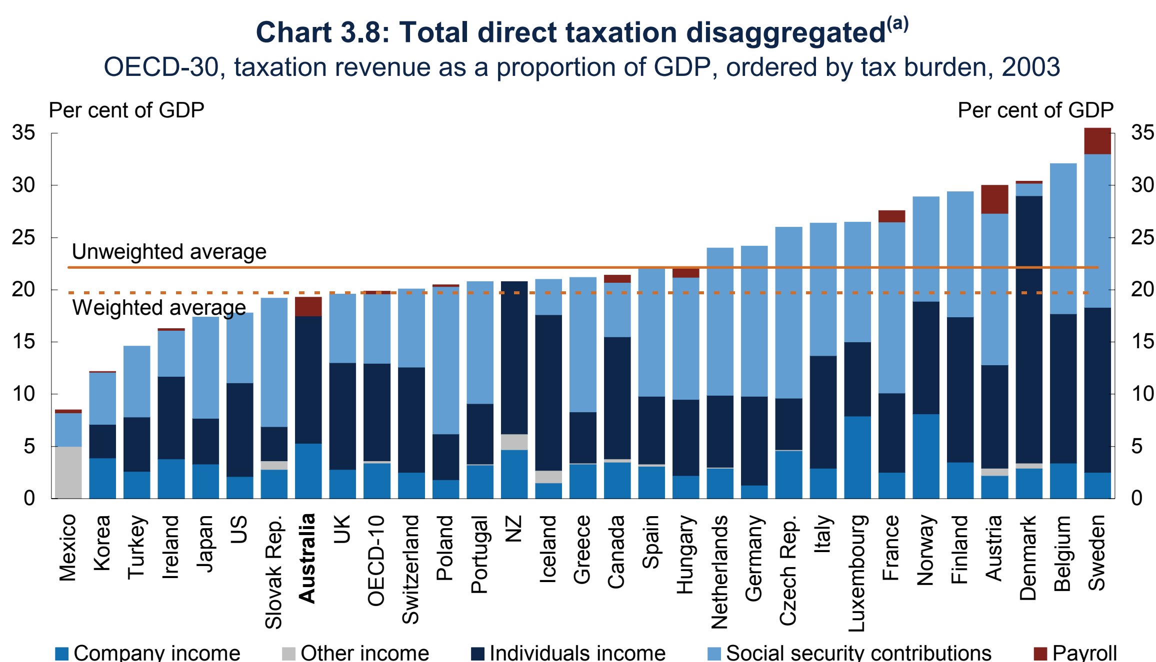
For the purpose of international comparison, there are significant risks in relying on disaggregated data. This particularly applies to direct taxation and the split between taxation on individuals and taxation on companies. Appendix 3.1 contains a discussion of these issues.

Total direct taxation

Total direct taxation consists of taxes levied directly on individuals' income, social security contributions, payrolls and companies' profits. It also includes an 'other' component which cannot be disaggregated, but which is significant for a small number of countries, including New Zealand.

Chart 3.8: Total direct taxation disaggregated[(a)]

OECD-30, taxation revenue as a proportion of GDP, ordered by tax burden, 2003



(a) For the purpose of international comparison, there are significant risks in relying on disaggregated data, especially in disaggregating taxes on income, profits and capital gains into its individuals, corporate and other components. A description of some of the issues is provided in Appendix 3.1.

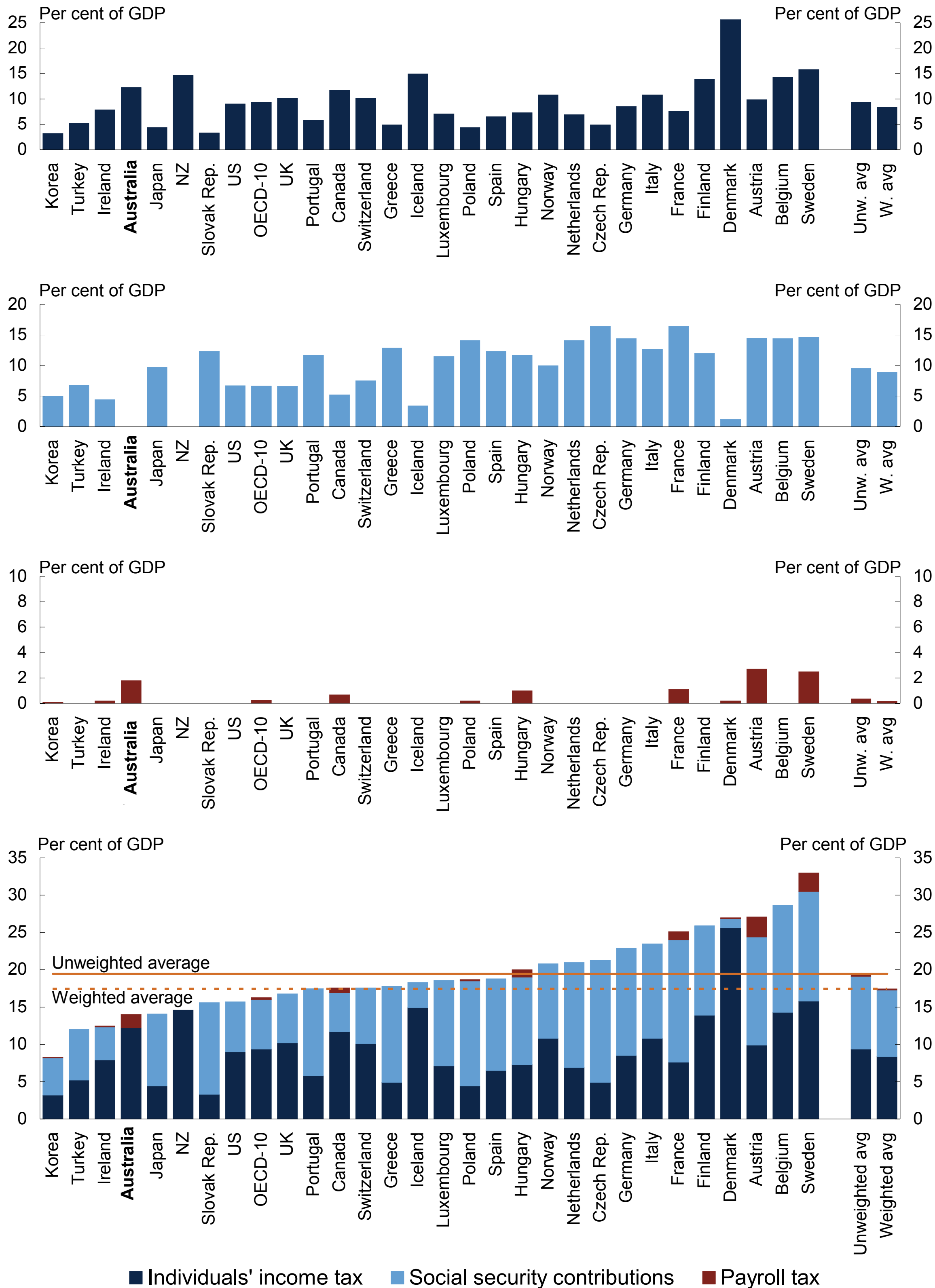
Source: OECD *Revenue Statistics*, 2005.

Australia's total income tax burden (19.3 per cent of GDP) is low by international standards — it is the eighth lowest in the OECD-30 (Chart 3.8). In comparison, the OECD-30 unweighted average is 22.2 per cent, the OECD-30 weighted average is 19.7 per cent, and the average for the OECD-10 is 19.9 per cent.

- Of the comparator OECD-10 countries, only Ireland (16.3 per cent), Japan (17.4 per cent) and the United States (17.8 per cent) have lower income tax burdens than Australia.

Chart 3.9: Components of direct taxation in respect of individuals and payrolls[(a)]

OECD-30, taxation revenue as a proportion of GDP, ordered by tax burden, 2003



(a) For the purpose of international comparison, there are significant risks in relying on disaggregated data, especially in disaggregating taxes on income, profits and capital gains into its individuals, corporate and other components. A description of these is provided in Appendix 3.1. Mexico doesn't provide a disaggregation of its income taxes.

Source: OECD *Revenue Statistics*, 2005.

Direct taxation in respect of individuals

Casual observers often conclude that Australia has relatively high levels of taxation on individuals' incomes because, when only personal income tax is taken into account, Australia ranks seventh highest in the OECD-30. Once social security contributions and payroll taxes are accounted for, Australia has the fourth lowest level of direct taxation on individuals and payroll in the OECD-30. (Chart 3.9)

- Australia's tax burden (14.0 per cent) is significantly lower than the OECD-30 weighted average (17.5 per cent), the OECD-30 unweighted average (19.5 per cent), and the average of the OECD-10 countries (16.3 per cent).
- Mexico is excluded from these comparisons because disaggregated data are not available. It is likely that Mexico has a lower individuals' income tax burden than Australia.

Payroll taxes are levied on a similar basis to social security contributions, and so are also considered a type of income tax.

- Personal income taxes, social security contributions and payroll tax, taken together, represent the difference between the cost of remuneration paid by employers and the after-tax remuneration received by employees.
- For Australia, the OECD's data on payroll taxes include state government levies on the payrolls of certain types of employers (usually larger employers) as well as the Australian Government's fringe benefits tax[1]. Ten OECD-30 countries, and three of the OECD-10, have revenues classified as taxation on payrolls and workforce.

Direct taxation in respect of companies

Casual observation would suggest that Australia has a relatively high corporate tax burden — 5.3 per cent of GDP, compared with the OECD-30 unweighted average of 3.3 per cent, the OECD-30 weighted average of 2.6 per cent, and the average for the OECD-10 of 3.4 per cent (Chart 3.10).

- Only Norway (8.1 per cent) and Luxembourg (7.9 per cent) have higher corporate tax burdens than Australia.

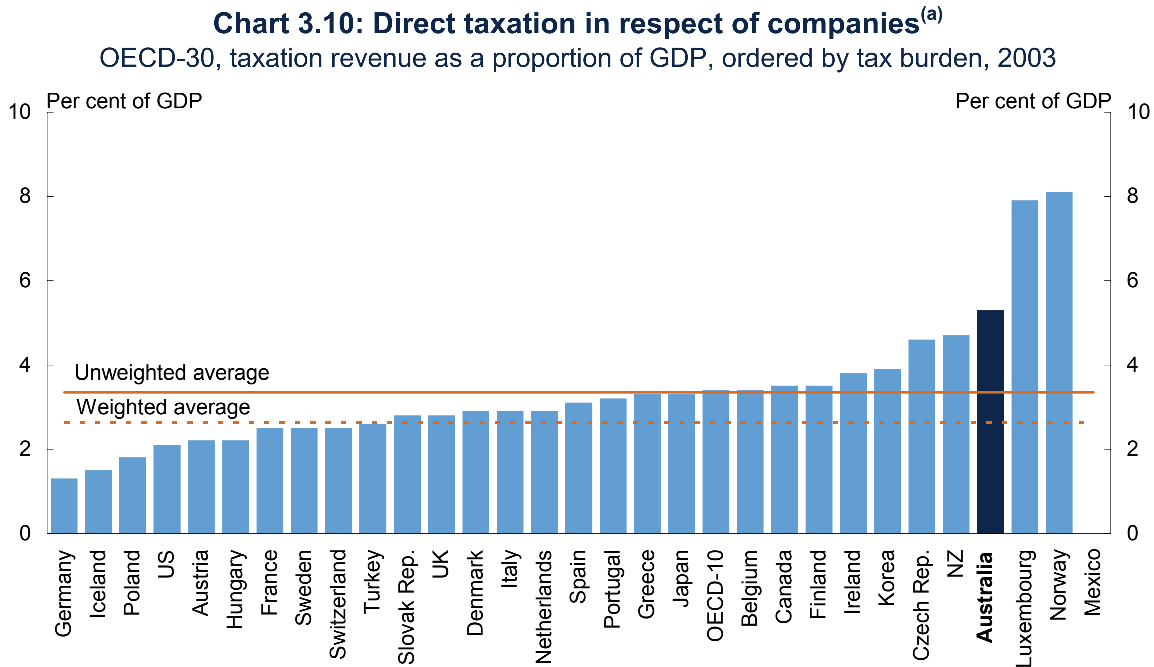
However, classification issues mean that it is difficult to draw conclusions from the data.

- A description of the numerous classification issues is provided in Appendix 3.1, including Australia's imputation system and the treatment of superannuation taxes.
- New Zealand also has a relatively high corporate tax burden (4.7 per cent of GDP); however, it may also be affected by some of the same classification issues as Australia — in particular, it also has an imputation system.

---

1 The Australian Bureau of Statistics has recently changed its classification of fringe benefits tax to be a tax on individuals (ABS cat. no. 5506.0). This is expected to flow through to the OECD classification in the 2006 edition of OECD *Revenue Statistics*.

Chart 3.10: Direct taxation in respect of companies[a]
OECD-30, taxation revenue as a proportion of GDP, ordered by tax burden, 2003



(a) For the purpose of international comparison, there are significant risks in relying on disaggregated data, especially in disaggregating taxes on income, profits and capital gains into its individuals, corporate and other components. A description of some of the issues is provided in Appendix 3.1. Mexico doesn't provide a disaggregation of its income taxes.
Source: OECD *Revenue Statistics*, 2005.

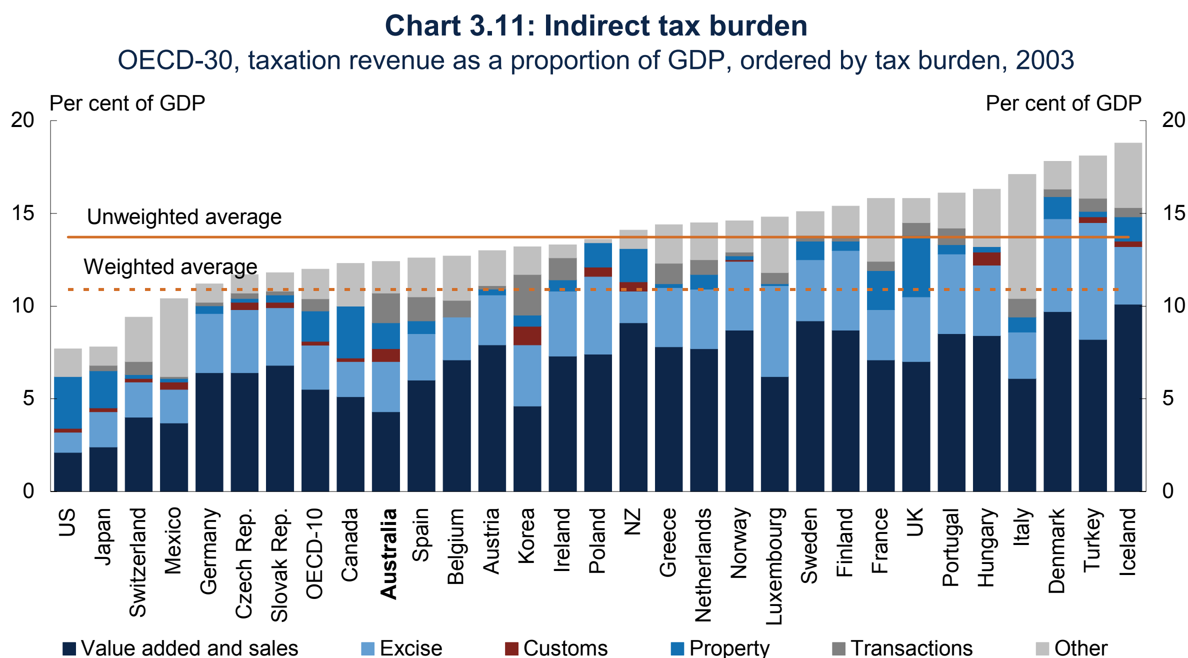
3.3.3 Indirect taxation

Australia's indirect tax burden (12.4 per cent of GDP) is lower than that of most other OECD countries — it is the ninth lowest in the OECD-30, and is also lower than the OECD-30 unweighted average (13.7 per cent). It is higher than the OECD-30 weighted average (10.9 per cent) and the average of the OECD-10 (12.0 per cent) — Chart 3.11.

The United States (7.7 per cent) and Japan (7.8 per cent) have the lowest indirect tax burdens, generating a relatively large differential between the weighted and unweighted averages.

Chart 3.11: Indirect tax burden

OECD-30, taxation revenue as a proportion of GDP, ordered by tax burden, 2003



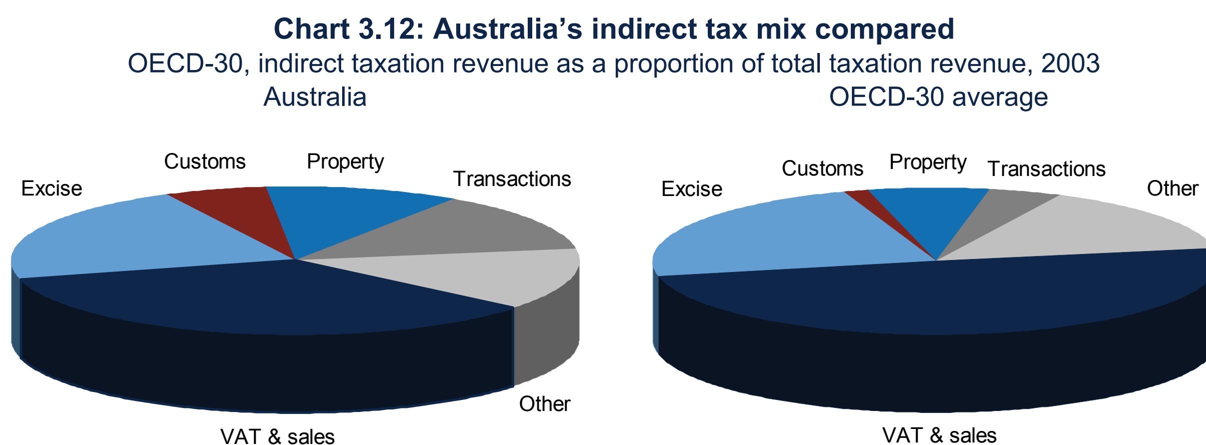
Source: OECD *Revenue Statistics*, 2005.

Australia's tax mix has a significantly lower reliance on value added and sales taxes (4.3 per cent) than the OECD-30 unweighted average (6.8 per cent) — Chart 3.12.

Australia raises around 3.4 per cent of GDP in excise and customs duties, in line with the OECD-30 average (3.4 per cent). However, there are several classification issues with customs duty which make it difficult to draw useful conclusions from the data.

Chart 3.12: Australia's indirect tax mix compared

OECD-30, indirect taxation revenue as a proportion of total taxation revenue, 2003



Source: OECD *Revenue Statistics*, 2005.

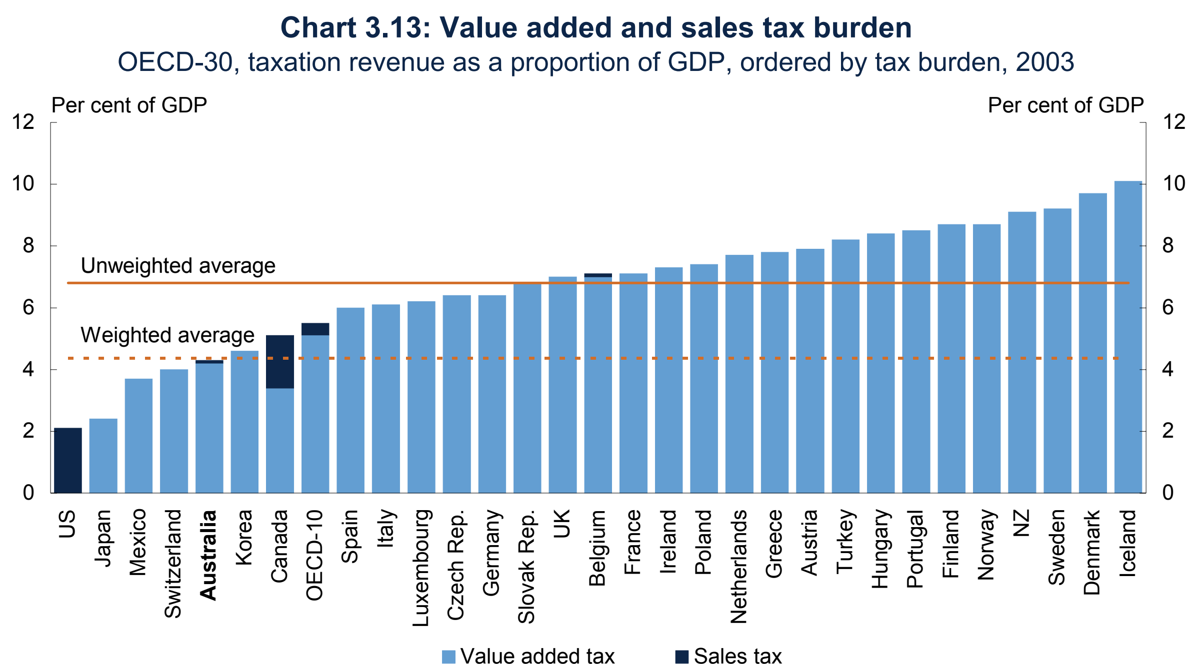
Australia has a relatively greater reliance on immovable property taxes (1.4 per cent of GDP) and transaction taxes (1.6 per cent) than the OECD-30 average (1.0 per cent and 0.6 per cent respectively).

Value added and sales taxes

Australia has a relatively low tax burden from value added and sales taxes (4.3 per cent of GDP) — it is the fifth lowest in the OECD-30 and is significantly lower than the OECD-30

unweighted average (6.8 per cent) and slightly lower than the OECD-30 weighted average (4.4 per cent) — Chart 3.13.

Chart 3.13: Value added and sales tax burden
OECD-30, taxation revenue as a proportion of GDP, ordered by tax burden, 2003



Source: OECD *Revenue Statistics*, 2005.

Excise and customs

Australia's revenue from excise and customs duties (3.4 per cent of GDP) is around the unweighted average for the OECD-30 (3.4 per cent) — Australia is thirteenth highest in terms of tax burden from excise and customs duty. The weighted average for the OECD-30 is 2.4 per cent and the average of the OECD-10 is 2.6 per cent (Chart 3.14).

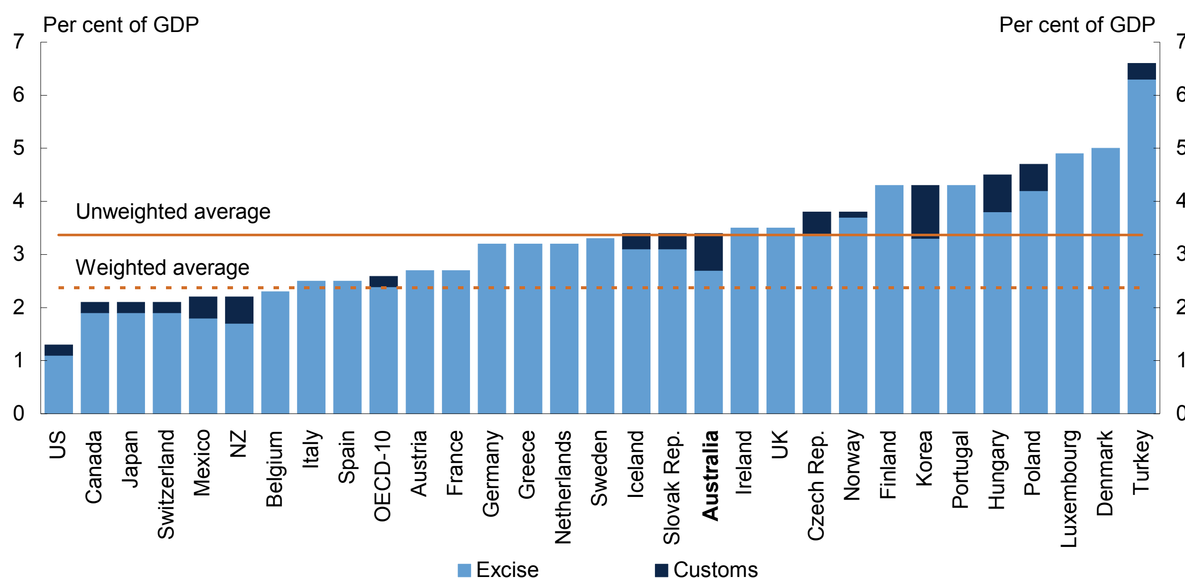
- The United States (1.3 per cent of GDP) has a low tax burden from excise and customs duty. Japan (2.1 per cent) is also lower than Australia.

As noted above, there are classification issues with customs duty which make it difficult to draw conclusions from the disaggregated excise and customs duty data.

- For the European Union countries, customs duty is treated as a supranational tax and excluded from the national tax burden.

- Where a customs duty replicates a domestic excise duty, the OECD classifies the customs duty revenue together with excise revenue rather than separately under the customs revenue classification. On the other hand, Australia is one country identified by the study which does not transform its customs revenue data in that way.

Chart 3.14: Excise and customs duty burden
OECD-30, taxation revenue as a proportion of GDP, ordered by tax burden, 2003



Source: OECD *Revenue Statistics*, 2005.

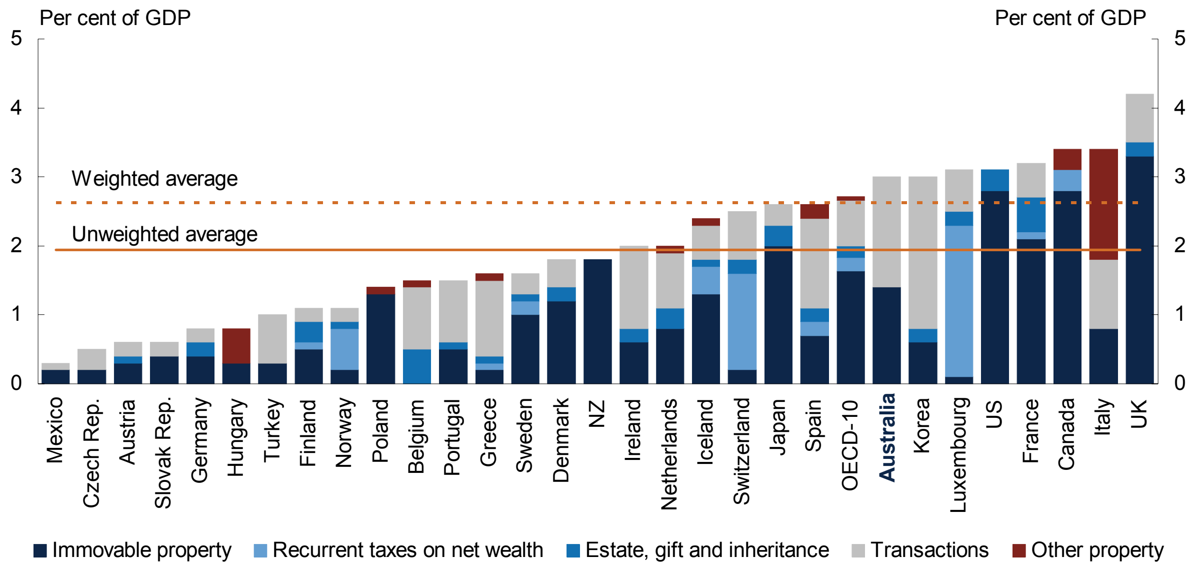
Property and transaction taxes

Australia has a relatively high reliance on property and transaction taxes (3.0 per cent of GDP) — Australia is seventh highest in terms of the tax burden. This is above the OECD-30 weighted average (2.6 per cent), the OECD-30 unweighted average (1.9 per cent), and the average of the OECD-10 comparator countries (2.7 per cent) — Chart 3.15.

- The United Kingdom (4.2 per cent of GDP) has the highest reliance on property and transaction taxes, and Canada (3.4 per cent) and the United States (3.1 per cent) are also high. All of these countries have a greater reliance on taxes on immovable property.

- Transaction taxes are a significant revenue source for Australia's state governments.

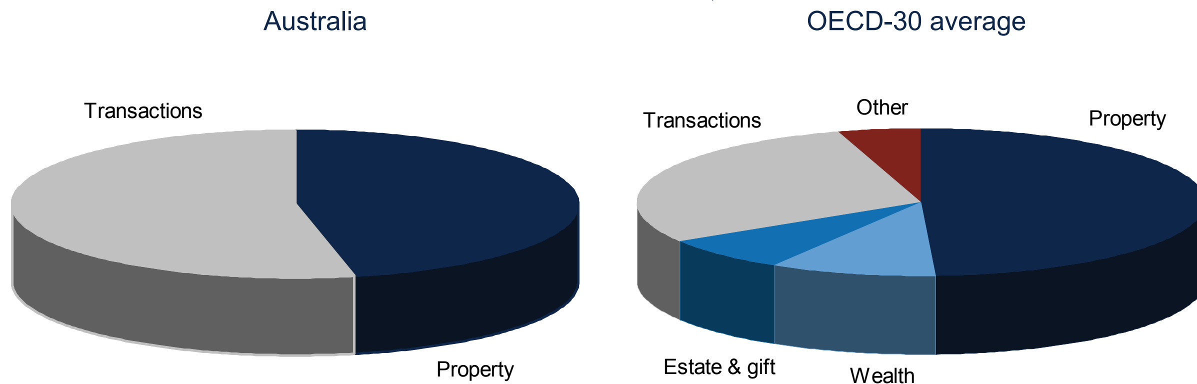
Chart 3.15: Property and transaction tax burden
OECD-30, taxation revenue as a proportion of GDP, ordered by tax burden, 2003



Source: OECD *Revenue Statistics*, 2005.

There is considerable diversity across the OECD in respect of the mix of property and transaction taxes (Chart 3.16). While the proportion of the tax mix from immovable property in Australia is similar to the OECD-30 average, Australia's transaction tax burden (1.6 per cent of GDP) is second highest in the OECD after Korea (2.2 per cent). Australia also raises no taxation revenues from wealth taxes or estate, inheritance and gift taxes.

Chart 3.16: Australia's property and transaction tax mix compared
OECD-30, property and transaction taxation revenue as a proportion of total taxation revenue, 2003



Source: OECD *Revenue Statistics*, 2005.

Immovable property taxes

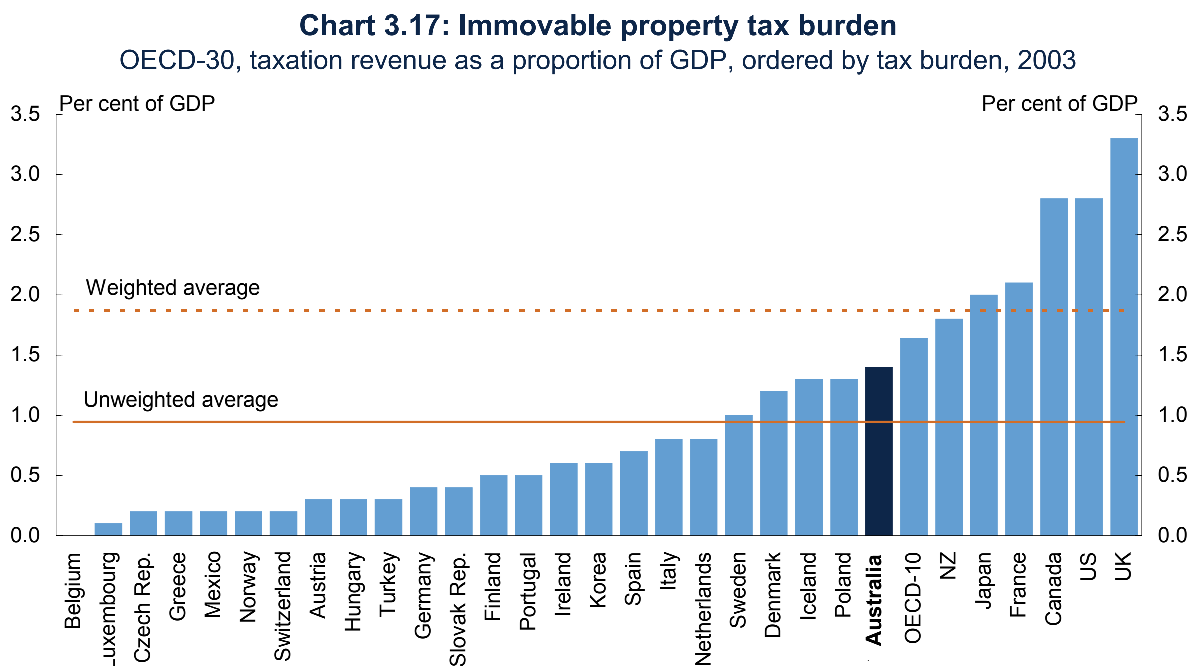
Taxes on property do not include taxes on incomes flowing from property ownership (for example, rental income) or taxes on incomes flowing from the sale of property (for example, capital gains). These types of taxes are included in the relevant categories of income taxation revenue. Property taxes include taxes levied on the ownership or transfer of immovable property (land and buildings), wealth and inheritances, and financial and capital transactions.

Compared with other OECD countries, Australia's taxes on immovable property (1.4 per cent of GDP) are the seventh highest. This is above the OECD-30 unweighted average (0.9 per cent), but below the OECD-30 weighted average (1.9 per cent) and the average of the OECD-10 comparator countries (1.6 per cent) — Chart 3.17.

- The United Kingdom (3.3 per cent of GDP) has the highest reliance on immovable property taxes, and the United States (2.8 per cent), Canada (2.8 per cent), Japan (2.0 per cent) and New Zealand (1.8 per cent) are also high.

Chart 3.17: Immovable property tax burden

OECD-30, taxation revenue as a proportion of GDP, ordered by tax burden, 2003



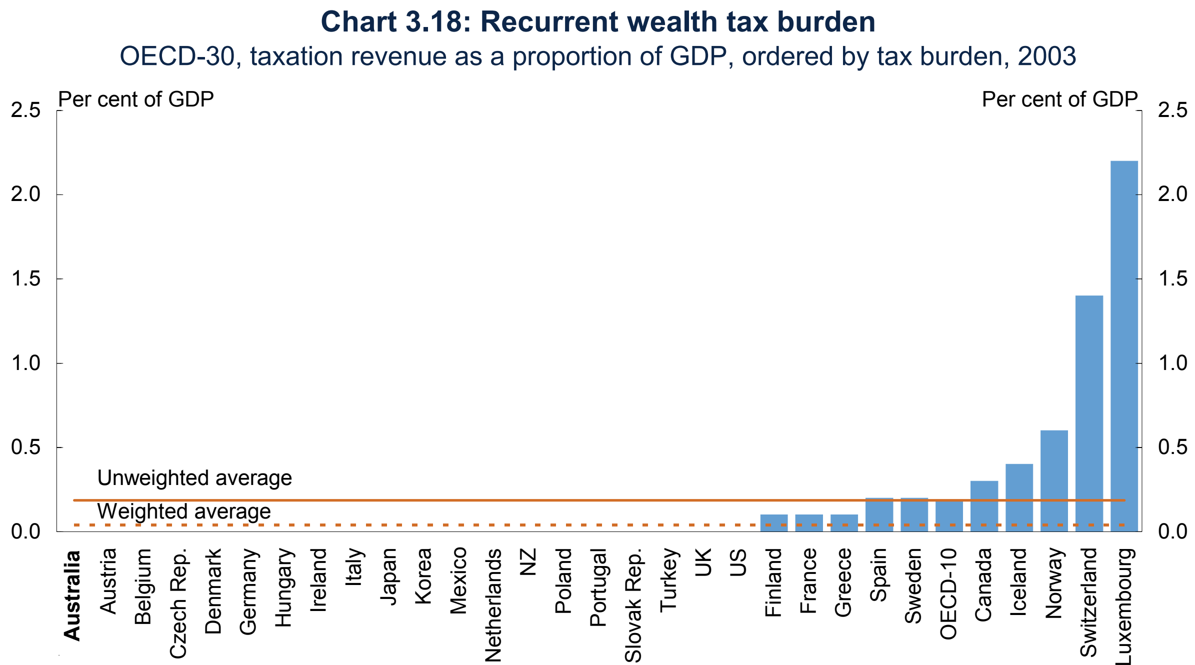
Source: OECD *Revenue Statistics*, 2005.

Recurrent wealth taxes

These taxes are usually levied annually on net wealth — that is, taxes in respect of movable and immovable property, net of any debt financing. Only a few countries levy this type of property tax. Australia does not have any taxes in this classification. Luxembourg (2.2 per cent of GDP) and Switzerland (1.4 per cent of GDP) stand out as having a relatively significant reliance on these taxes in their mix (Chart 3.18).

Chart 3.18: Recurrent wealth tax burden

OECD-30, taxation revenue as a proportion of GDP, ordered by tax burden, 2003



Source: OECD *Revenue Statistics*, 2005.

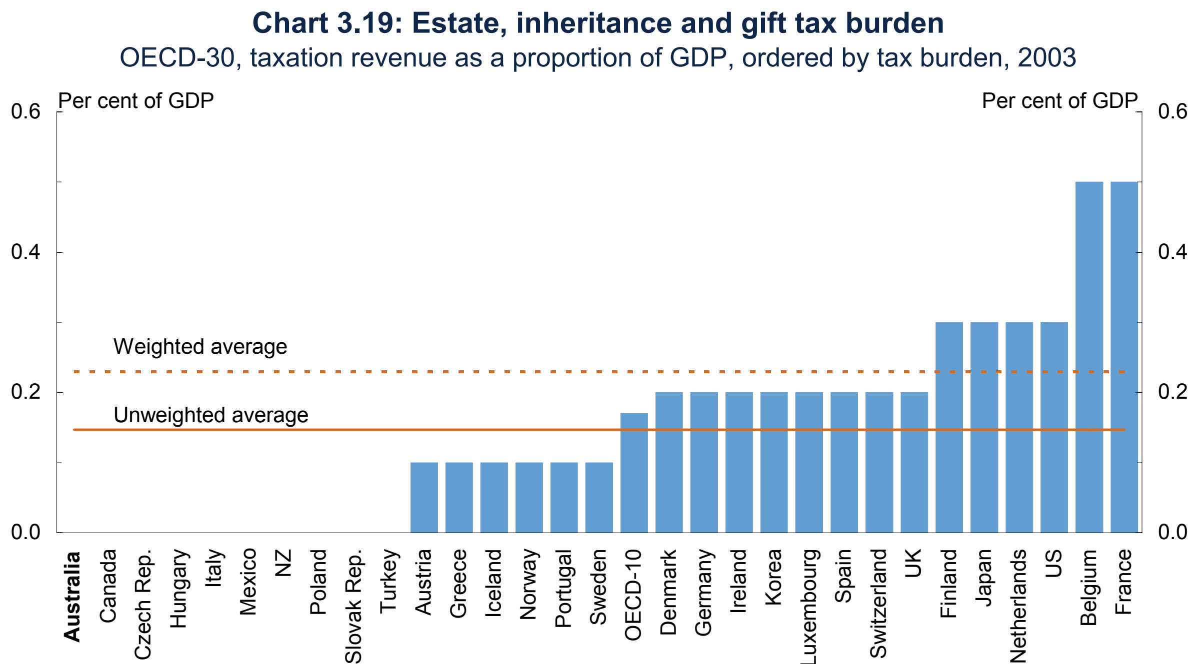
Estate, inheritance and gift taxes

Australia is in a group of ten OECD countries that do not impose any estate, inheritance and gift duties (Chart 3.19).

- Belgium (0.5 per cent of GDP) and France (0.5 per cent) have the highest reliance on these types of tax. The United States (0.3 per cent) and Japan (0.3 per cent) also have a relatively higher reliance on these taxes.

Chart 3.19: Estate, inheritance and gift tax burden

OECD-30, taxation revenue as a proportion of GDP, ordered by tax burden, 2003



Source: OECD *Revenue Statistics*, 2005.

Transaction taxes

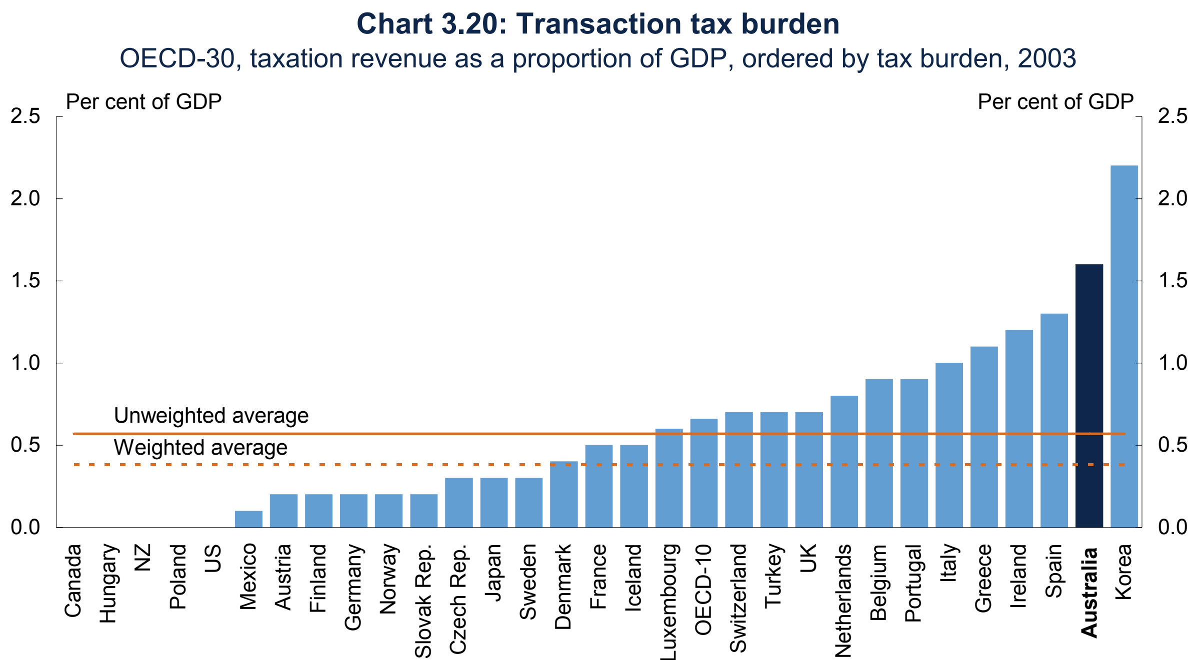
Transaction taxes include taxes on the transfer of securities or property, financial transactions such as cheques, and legal transactions such as the validation of contracts.

Australia's reliance on transaction taxes (1.6 per cent of GDP) is second highest in the OECD-30. This is well above the OECD-30 unweighted average (0.6 per cent), the OECD-30 weighted average (0.4 per cent) and the average of the OECD-10 comparator countries (0.7 per cent) — Chart 3.20.

- Korea (2.2 per cent of GDP) has the highest reliance on property taxes. Of the OECD-10 comparator countries, the Spain (1.3 per cent) and Ireland (1.2 per cent) have the highest reliance on transaction taxes.

Chart 3.20: Transaction tax burden

OECD-30, taxation revenue as a proportion of GDP, ordered by tax burden, 2003



Source: OECD *Revenue Statistics*, 2005.

APPENDIX 3.1: CLASSIFICATION ISSUES IN DISAGGREGATING INCOME TAXES

For the purpose of international comparison, there are significant risks in relying on disaggregated data. This can reflect differences in the structure of economies and taxation systems.

In particular, the disaggregation of income taxes into its individuals and companies components must be treated with significant caution. There are many classification-related reasons why a simple comparison of Australia's corporate income taxation with that of other countries is misleading. It is important to bear in mind that these issues mostly affect the classification of taxation revenue, not the level of overall tax burden. So a classification issue which overstates the burden of corporate taxation also understates the burden of other classifications of taxation.

- Australia's imputation credit system means that a significant proportion of company tax revenue represents withholding tax payments in respect of individual's income tax liabilities.

- Unlike most countries, Australia's company tax revenue includes taxes on superannuation funds, levied on both contributions and earnings. While the legal incidence of these taxes is on incorporated superannuation funds and life assurance companies, the economic incidence rests with the individual.

- For Australia, company tax revenue includes petroleum resource rent tax revenue. This tax is levied on the economic profits of certain petroleum production projects where those profits are not taxed elsewhere through excise or royalties. The taxation revenue represents a return to the community for the depletion of a natural resource. The rent tax was previously imposed as an excise, and other rent taxes are imposed as excise or royalties. In this case, the choice of taxation instrument fundamentally changes the tax mix while the actual tax burden on companies is no different.

- There are different levels of incorporation between countries. This reflects factors other than the level of business activity. For example, Germany has a low level of incorporation of business (but not a low level of business activity), and so taxes on its business activity mostly show up in taxes on individuals rather than taxes on corporate income. Similarly, 'S corporations' in the United States (similar to Australia's trusts) account for a significant proportion of all business activity, but taxation revenue from this sector appears as taxation on individuals rather than taxation on companies.

- Income taxes that can not be attributed to either individuals or companies can be relatively large for some countries. In the case of Mexico, all income tax is in this category. New Zealand also has about 1.5 percentage points of the income tax burden which cannot be split between individuals and companies.

- For the purpose of this report, these unallocated amounts are ignored for analysis of disaggregated revenue data, but are included in the analysis at the income tax level of aggregation.

Furthermore, different tax systems may change the incentives for economic agents to structure their affairs. For example, capital gains tax concessions in different countries can influence the way companies behave. If capital gains are taxed concessionally (either through deferral of income recognition from economic accrual to realisation, or through concessional rates of tax), there is an incentive for shareholders to accrue capital gains through appreciating the value of the company by retaining and reinvesting profits, and then realising those gains through equity transfers, rather than distributing the profits as dividends. While this incentive exists for Australia, it is counter-balanced by the imputation system which encourages the distribution of taxed profits as franked dividends to shareholders, rather than retaining and reinvesting those profits.

APPENDIX 3.2: DATA TABLES

Appendix table 3.2.1: Tax burden in OECD countries, 2003

	Supranational	National	Provincial	Local	Social Security Funds
Federal countries					
Australia		68.1	29.0	3.0	
Austria	0.2	54.6	8.5	9.4	27.3
Belgium	1.3	34.0	23.8	5.3	35.7
Canada		44.8	37.9	8.6	8.7
Germany	0.9	30.2	21.6	6.8	40.5
Mexico		79.9	2.2	1.0	16.9
Switzerland		34.1	24.2	16.2	25.5
United States		38.8	20.2	14.7	26.4
Unweighted average	0.8	48.0	20.9	8.1	22.6
Unitary countries					
Czech Republic		43.8		12.7	43.6
Denmark	0.3	61.5		35.7	2.5
Finland	0.2	54.3		21.1	24.5
France	1.0	39.4		10.3	49.4
Greece	1.0	62.5		0.9	35.6
Hungary		63.9		5.8	30.3
Iceland		75.3		24.7	
Ireland	0.4	84.9		2.1	12.6
Italy	0.3	53.4		16.9	29.5
Japan		35.8		25.7	38.5
Korea		62.4		18.0	19.5
Luxembourg	0.7	66.1		5.9	27.2
Netherlands	1.0	58.8		3.9	36.3
New Zealand		94.4		5.6	
Norway		85.3		14.7	
Poland		50.7		8.0	41.4
Portugal	0.9	60.3		5.8	33.0
Slovak Republic		56.2		5.1	38.7
Spain	0.4	37.0		28.2	34.4
Sweden	0.7	55.0		32.7	11.6
Turkey		73.4		5.8	20.8
United Kingdom	1.2	75.5		4.8	18.5

Source: OECD *Revenue Statistics*, 2005.

Chapter 4

Wage and salary taxation

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4. WAGE AND SALARY TAXATION

SUMMARY

Australia's total wage and salary tax take as a proportion of GDP is low compared with the OECD-30 and the OECD-10. While Australia's individual income tax burden is relatively high compared to the OECD-30 and OECD-10, once social security contributions and payroll taxes are accounted for, Australia has the second lowest level of direct taxation on individuals and payroll in the OECD-10.

The components of wage and salary taxation considered in this chapter include personal income tax, social security contributions and payroll taxes.

Different countries use various methods of taxing wages and salaries and different methods of providing assistance to groups such as low income earners, families and the unemployed. In order to make meaningful comparisons, a comprehensive measure is required that considers all components of the tax burden. The most comprehensive measure available is the 'tax wedge'. This measure encompasses the entirety of wage-based taxes imposed by governments, taking into account the interchangeablity of cash benefits and tax relief.

The average tax rate (total tax as a proportion of income) for a worker earning the male average wage in Australia has been steady at around 22 per cent over the past 40 years. The marginal tax rate (the rate of tax paid on an additional dollar of income) for the same worker has averaged around 35 per cent.

Australia's personal income tax structure (including rates and base) has similar characteristics to the OECD-10 and OECD-30. Australia's top marginal tax rate of 48.5 per cent is slightly higher than the average top marginal tax rate for both the OECD-10 (second highest) and the OECD-30 (eleventh highest). Australia's threshold, to which the top marginal tax rate applies, is sixth highest in the OECD-10 and twelfth highest in the OECD-30. Based on available information, at least three of the OECD-10 (Canada, the Netherlands and the United States) automatically index their national personal income tax thresholds to inflation. Many of the other OECD-10 use some form of partial indexation.

The combined progressivity of Australia's personal income tax system and welfare system is higher than for most of the OECD-10. This particularly reflects the targeted nature of the welfare system. However, it should be noted that progressivity does not in itself equate to equity.

Australia's tax wedge is ranked amongst the lowest four in the OECD-10 for seven of the eight different family scenarios considered by the OECD. However, Australia's tax wedge

for a single person earning 167 per cent of the average wages[1] is ranked fifth highest in the OECD-10. Australia's tax wedge is ranked amongst the lowest eight in the OECD-30 for the eight different family scenarios.

As a result of Australia's tightly targeted welfare system, effective marginal tax rates are generally ranked higher against the OECD-10 than is the case for average tax rates. Australia's marginal tax wedge is ranked second highest in the OECD-10 for two of the eight family scenarios. Comparisons with the OECD-30 vary considerably depending on the income of the household.

Another measure of tax burden considered in this chapter is the net personal average tax rate. The net personal average tax rate includes personal income tax plus employee social security contributions minus cash benefits. Australia's net personal average tax rate is generally higher than the OECD-10 average, but lower than the OECD-30 average. The marginal equivalent for this measure for the eight family types show that Australia generally has a higher net personal marginal tax rate than the OECD-10, while the results for the OECD-30 vary depending on the family type considered.

Comparisons between the different family situations are considered in Appendices 4.3 and 4.4. The comparisons show the effect of the tax treatment for singles and families, the inclusion of dependants for single- and dual-income families, and the tax burden for secondary earners entering the workforce.

- Generally, across all OECD-30 countries the tax wedge for single- and dual-income families decreases with the inclusion of children. Australia is no exception; in fact, the decrease in the tax wedge in Australia exceeds both the OECD-30 and OECD-10 average decrease for both the single- and dual-income families considered.

- Australia's marginal tax wedge increases for families with dependent children owing to the phasing-out of cash benefits.

4.1 INTRODUCTION

Wage and salary income is often described as earned income and is distinguished from more passive forms of income such as investment income or capital income. More detail on capital income is considered in Chapter 7.

Wage and salary income is subject to three forms of direct taxation — personal income tax, social security contributions and payroll tax. All three of these aspects are considered in this chapter. For a discussion on social security contributions and Australia's Superannuation Guarantee see Box 2.1.

This chapter presents a methodology for considering the overall tax and benefits position for households. This comprehensive measure is the tax wedge and it takes into consideration the key factors that determine an individual's disposable income. Much of the analysis contained

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1 Average wage is as defined by the OECD. This is explained in Box 4.2. In Australian dollar terms, 167 per cent of average wages in Australia in 2004-05 was A$85,452; 100 per cent of average wages in Australia in 2004-05 was A$51,169; 67 per cent of average wages in Australia in 2004-05 was A$34,283.

in Appendices 4.1 and 4.3 compares the tax wedge for a number of different family situations.

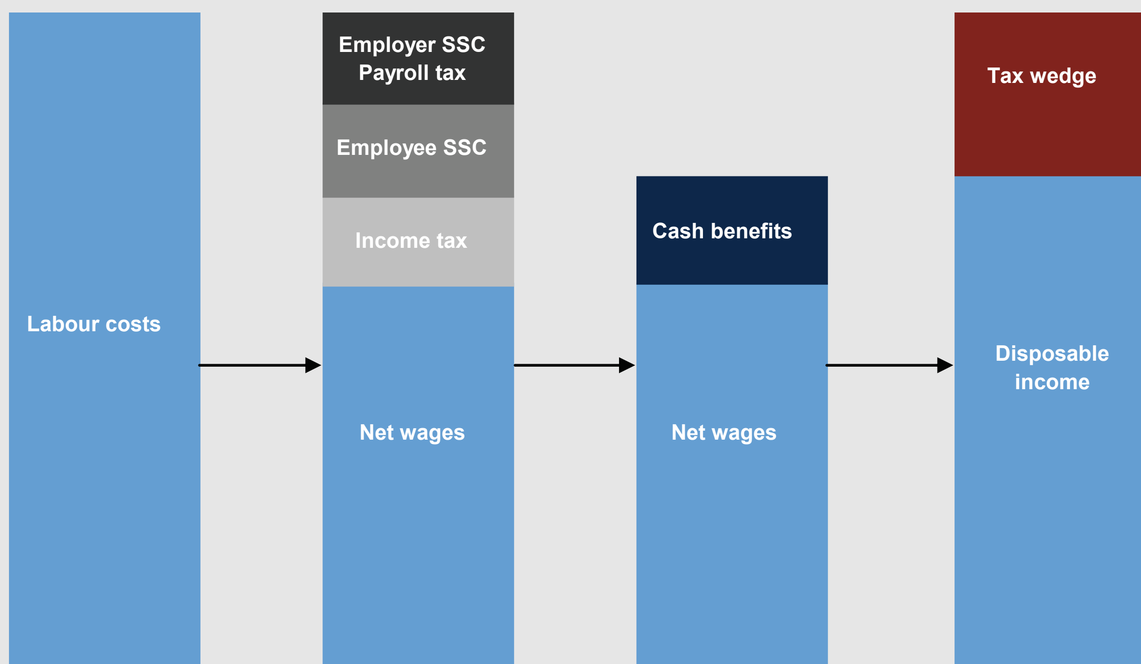
No single measure can capture all the salient aspects of any given taxation system. The optimal insight into a country's taxation system is obtained through the collective consideration of all available measures, rather than through any particular measure in isolation.

This chapter also considers other important aspects of the personal income tax system such as the system's rates and thresholds, progressivity and base.

Box 4.1: Tax wedge

The tax wedge is a measure of the difference between the total labour cost to an employer and the corresponding disposable income of an employee. The tax wedge is the sum of personal income tax (at all levels of government), employee and employer social security contributions (SSC) and payroll taxes minus any cash benefits from government welfare programmes. The tax wedge is usually expressed as a percentage of the total labour costs. This measure is illustrated diagrammatically in Chart 4.1.

Chart 4.1: Illustration of the tax wedge



4.2 BROAD INTERNATIONAL COMPARISONS

4.2.1 Direct tax mix in respect of individuals and payroll

Like other OECD countries, Australia raises the majority of its taxation revenue (60.9 per cent in 2003) from direct taxation levied on incomes — wages, salaries and profits, however, the

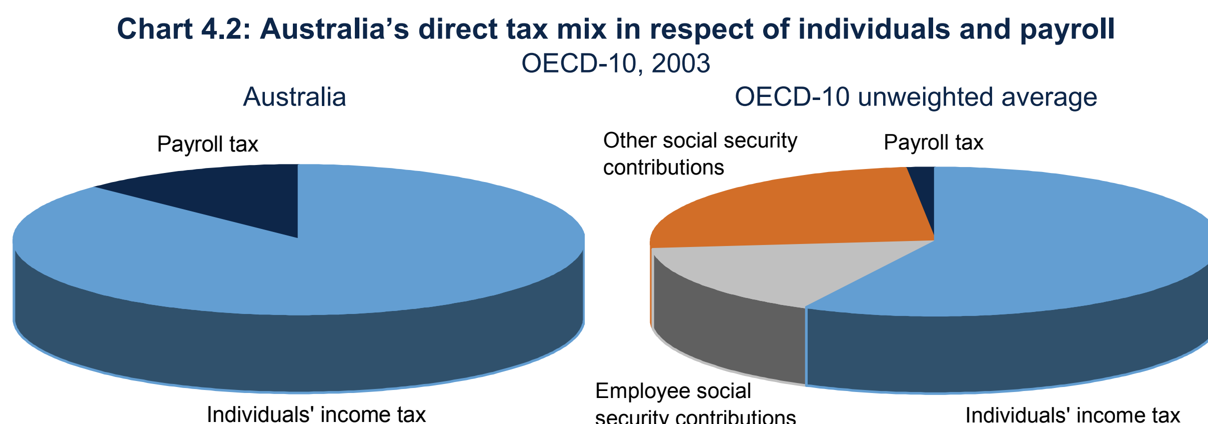
composition of Australia's taxation of earned income is different from that of most other OECD countries (Chart 4.2 and 4.3).

As discussed in Chapter 3, payroll taxes are levied on a similar basis to social security contributions and as such are considered a form of tax on labour. While it is difficult to substantiate the actual incidence of payroll taxes, it is widespread practice to assume that taxes levied in respect of remuneration are ultimately borne by the employee.

Chart 4.2 compares Australia's direct tax mix in respect of individuals and payroll with the average for the OECD-10. Australia's income tax from individuals accounts for over 85 per cent of the total direct tax mix in respect of individuals and payroll, compared with the average for the OECD-10 of around 60 per cent of the total tax mix. Social security contributions and payroll taxes account for the remaining 40 per cent of the total tax in respect of individuals and payroll for the OECD-10.

Chart 4.2: Australia's direct tax mix in respect of individuals and payroll

OECD-10, 2003



Source: OECD *Revenue Statistics*, 2005.

4.2.2 Direct taxation in respect of individuals and payroll

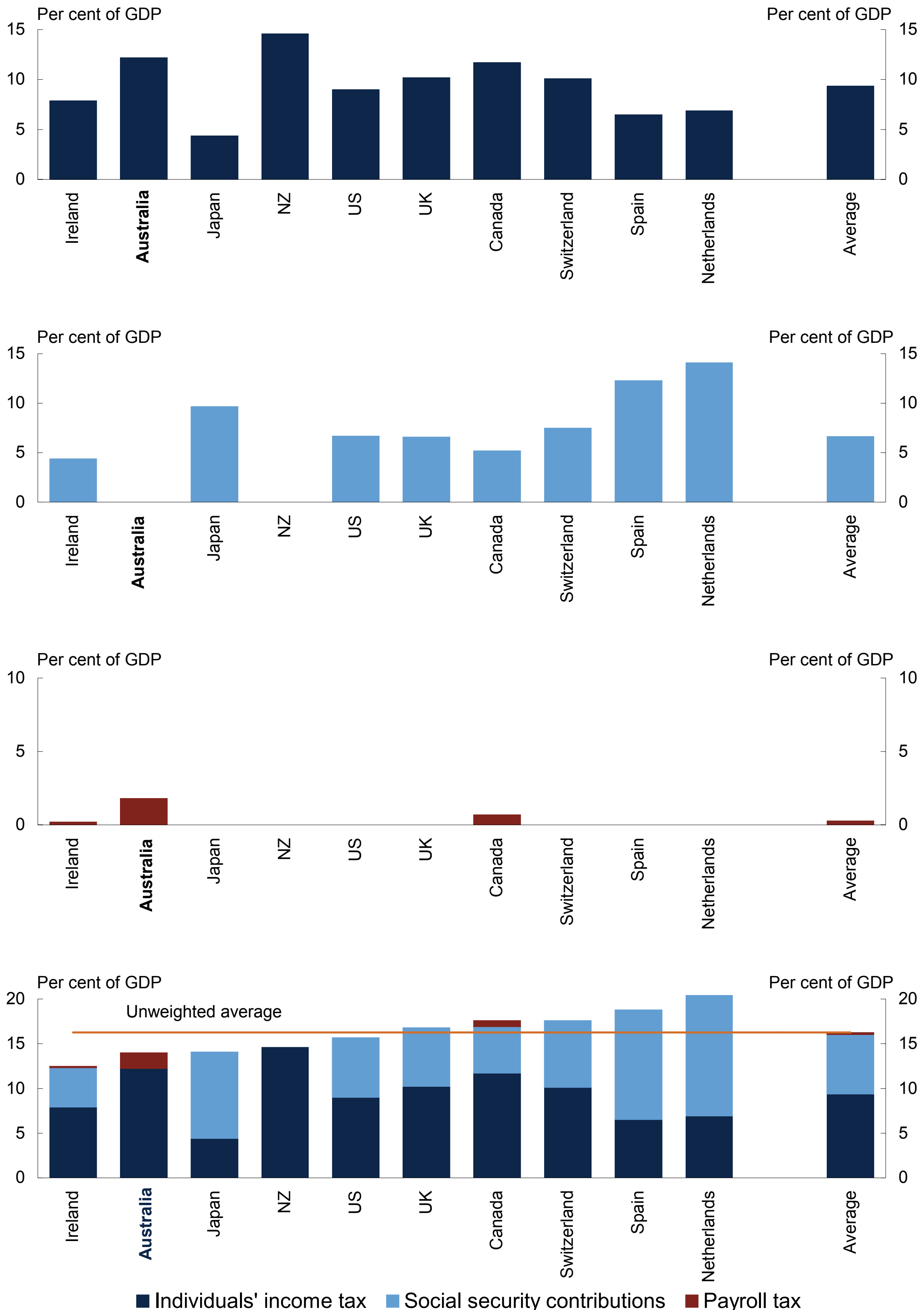
As discussed in detail in Appendix 3.1, classification issues make comparisons of the headline income tax burden on individuals difficult. Despite these limitations, including the need to exercise care when analysing income tax data disaggregated into its personal and corporate components, this is the most frequent measure used in commentary about tax burden.

Chart 4.3 compares Australia's direct tax burden in respect of individuals and payroll with the OECD-10. Casual observers often conclude that Australia has relatively high levels of taxation on individuals' incomes because Australia's individual income tax burden is second highest in the OECD-10.

However, once social security contributions and payroll taxes are accounted for, Australia has the second lowest level of direct taxation on individuals and payroll in the OECD-10 (14.0 per cent of GDP). This is below the unweighted average of 16.3 per cent of GDP. In Japan, the Netherlands and Spain, social security contributions are a larger source of taxation revenue than individuals' income tax.

Chart 4.3: Components of direct taxation in respect of individuals and payrolls[(a)]

OECD-10, taxation revenue as a proportion of GDP, ordered by tax burden, 2003

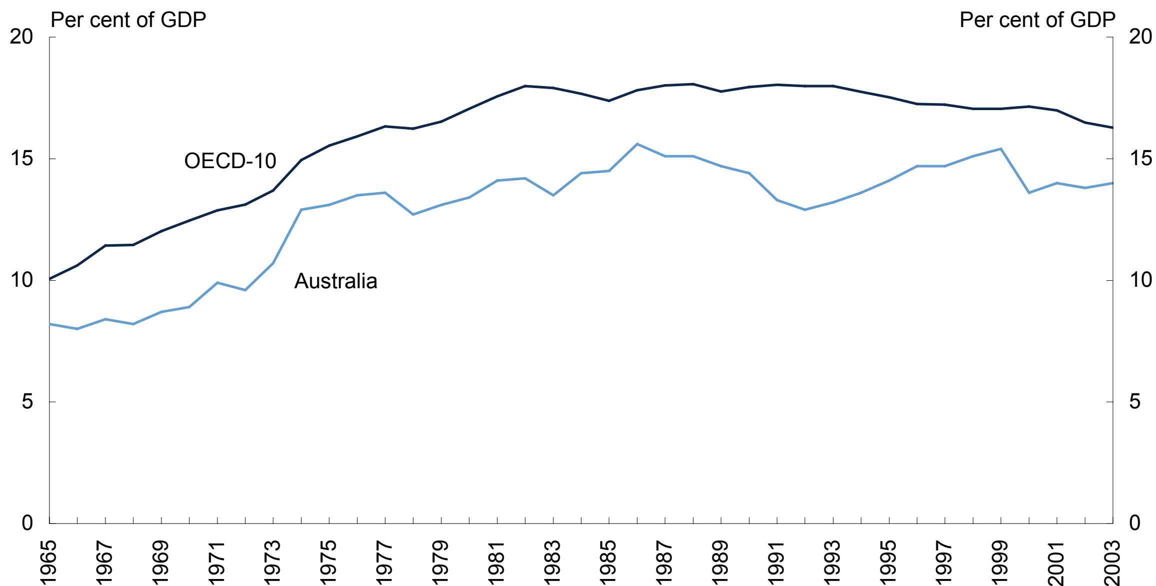


(a) For the purpose of international comparison, there are significant risks in relying on disaggregated data, especially in disaggregating taxes on income, profits and capital gains into its individuals, corporate and other components. A description of these is provided in Appendix 3.1.

Source: OECD *Revenue Statistics*, 2005.

Australia has always had a low tax burden in respect of individuals and payroll, when compared with the OECD-10 (Chart 4.4). In fact, Australia's tax burden has on average been around 20 per cent lower than the OECD-10 over the period since 1965.

Chart 4.4: The Australian personal tax burden in perspective
OECD-10, total direct taxation revenue in respect of individuals and payroll as a proportion of GDP, 1965-2003



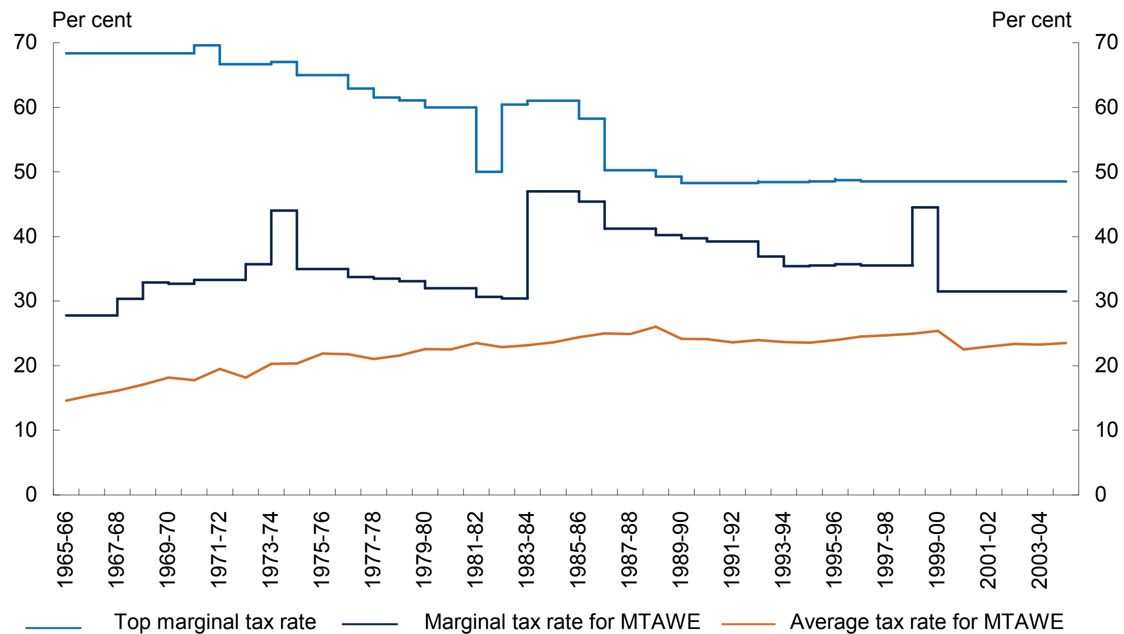
Source: OECD *Revenue Statistics*, 2005.

Over the past 40 years Australia's personal tax burden has increased from around 8 per cent of GDP to 14 per cent of GDP. After an increase in the tax burden in the early 1970s, the burden has remained relatively stable between 13 and 16 per cent of GDP.

4.2.3 History of average and marginal tax rates

Chart 4.5 shows the top marginal tax rate, the marginal and average tax rates applicable to a male earning an average wage (male total average weekly earnings or MTAWE). Both measures include the Medicare levy where applicable.

Chart 4.5: Marginal and average personal tax rates
Australia, 1965-66 to 2004-05



Source: Australian Treasury estimates.

Australia's top marginal tax rate has decreased over the past 40 years from almost 70 per cent to its current level of 48.5 per cent (including the Medicare levy). The marginal tax rate for MTAWE has ranged from 28 per cent to 47 per cent. Since 2000-01, the marginal tax rate for a person on MTAWE has been 31.5 per cent (including Medicare levy).

The average tax rate (total tax as a proportion of income) for a person on MTAWE in Australia has been steady at around 22 per cent over the past 40 years. In comparison, the marginal tax rate (the rate of tax paid on an additional dollar of income) for the same person has averaged around 35 per cent.

4.2.4 Tax wedge

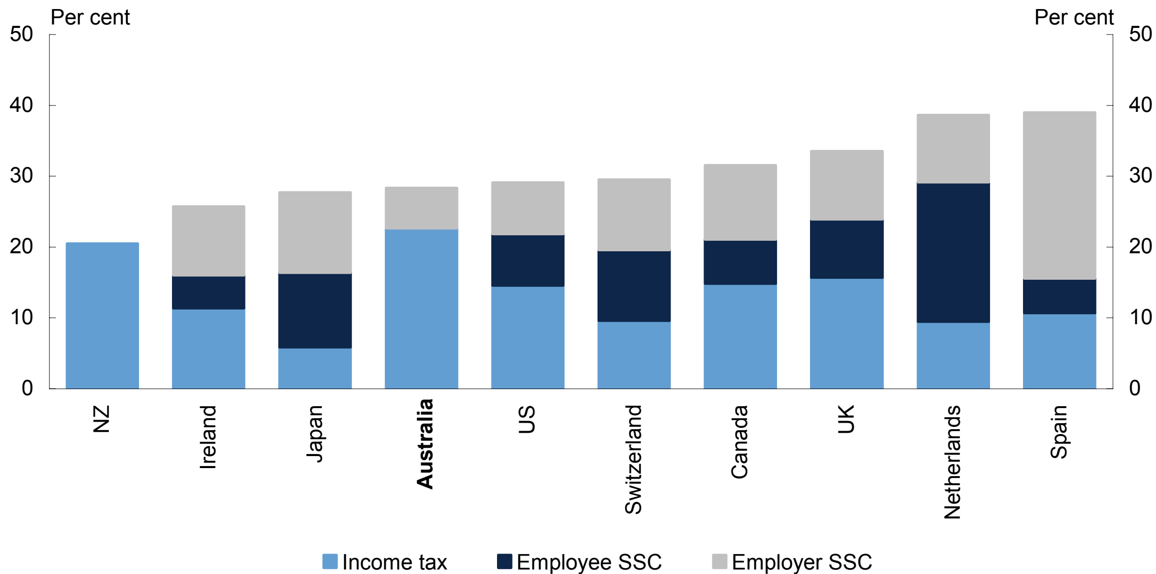
The tax wedge captures the overall difference between the disposable income of an employee and the corresponding costs incurred by their employer. It is the standard measure used for comparing tax burdens on wage income across countries and through time and is the cornerstone of the OECD's publication *Taxing Wages*.

Tax wedge analysis demonstrates how personal income tax, social security contributions paid by employees and employers and cash benefits affect various types of families in different countries in the OECD. This allows for a country-based comparison of labour costs and the overall tax and benefit position of families. This analysis is discussed in greater detail in Appendix 4.1. Another measure of tax burden is the net personal average tax rate and this is considered in Appendix 4.2.

Chart 4.6 shows the composition of the tax wedge for the OECD-10 for an average worker with no dependent children. Cash benefits are not included as the average worker with no children does not receive any cash benefits in any OECD country. Chart 4.6 shows that the

tax wedge for an average worker with no children in Australia is the fourth lowest in the OECD-10.

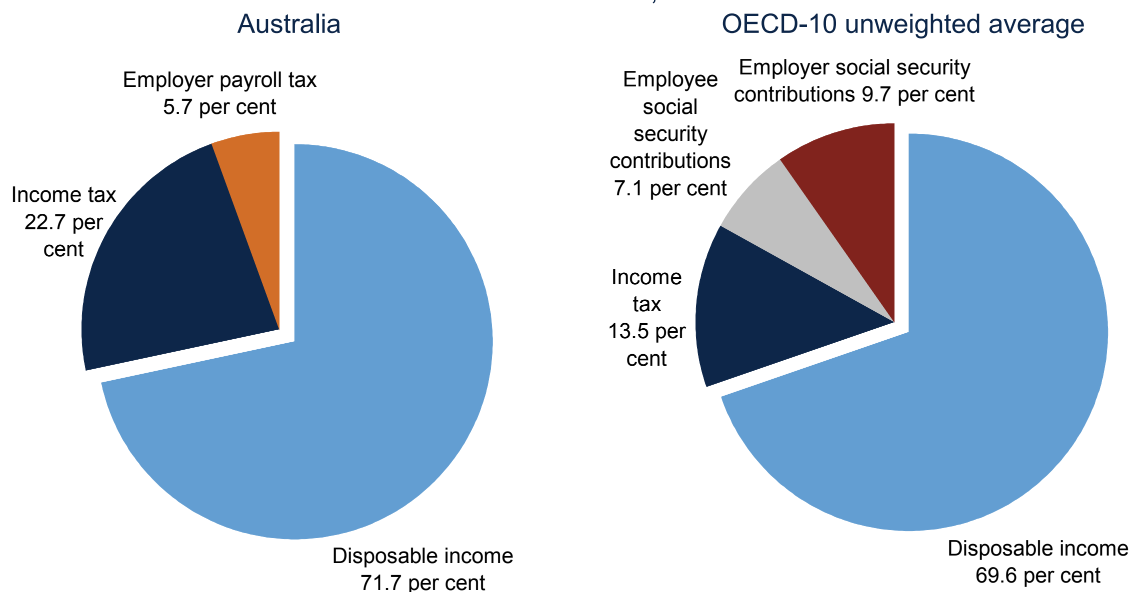
Chart 4.6: Tax wedge for an average worker
OECD-10, 2005[(a)]



(a) Refers to a single average worker with no dependants. The tax wedge includes income tax plus employee and employer social security contributions. The OECD's *Taxing Wages* publication includes payroll taxes in its treatment of employer social security contributions.
Source: OECD *Taxing Wages*, 2005.

Chart 4.7 shows the composition of the tax wedge for an average worker with no children in Australia against the OECD-10. This shows that while Australia's structure of direct taxes on individuals and payroll varies from the average, the end result is that the proportion of labour costs that the average worker receives as disposable income in Australia is very similar to that for the average worker for the OECD-10. The actual disposable income depends on the wage levels as well as tax wedges.

Chart 4.7: Comparison of the tax wedge components for an average worker[(a)]
Australia and OECD-10, 2005



(a) Refers to a single average worker with no dependants.

Source: OECD *Taxing Wages*, 2005.

The tax wedge varies depending on the level and composition of the family and private income. In order to compare tax systems, the OECD calculates tax wedges for eight different hypothetical family scenarios. Appendix 4.1 outlines these family scenarios and illustrates and compares the tax wedge across the OECD-30. Comparisons between the different family scenarios are considered in Appendix 4.3. The comparisons show the effect of the inclusion of dependants for single-and dual-income households as well as the effect of secondary earners entering the workforce.

In summary, the tax wedge for workers in Australia is consistently ranked among the lowest eight in the OECD-30 for each of the eight family types considered and among the lowest six in the OECD-10 countries. Australia's tax wedge is lower than the average for the OECD-10 for all eight scenarios except for a single-income person earning 167 per cent of average wages.

Another measure of the tax burden is the net personal average tax rate. The net personal average tax rate is a measure of the employee's total wage-based tax burden. The net personal average tax rate can be described as a measure of a family household's wage-based disposable income, and is important since it is a measure of the employee's incentive to increase the number of hours they work or to seek promotion.

The net personal average tax rate is the sum of personal income tax plus employee social security contributions, minus cash benefits as a percentage of gross wage earnings. That is, this measure excludes employer social security contributions and payroll taxes and the base is gross wages rather than total labour costs. The results of the net personal average tax rate for the eight different family types are contained in Appendix 4.2.

Australia's net personal average tax rate is generally higher than the average for the OECD-10 with two exceptions, sole parents with two children earning 67 per cent of average wages and single-income families with two children earning 100 per cent of average wages.

Box 4.2: Measures of wage earnings

The wage measure used in this chapter is the average wage for an average worker (AW). This measure is the OECD's average wage measure and therefore allows for international comparisons. The average wage is the average gross wage for persons engaged in full-time manual or non-manual labour for a certain range of industries.[2]

In 2004-05 Australia's average wage was A$51,169 (on a US dollars purchasing power parity basis this is US$36,851).

The OECD's average wage measure differs from other commonly used average wage indicators in Australia.

One measure of wage earnings is average weekly ordinary time earnings for full-time adults (AWOTE). This measure includes all cash earnings of an employee which are received on a regular and recurring basis but excludes overtime payments. The average value of AWOTE for 2004-05 was A$51,206.

Another Australian measure of wage earnings is average weekly earnings (AWE). AWE is calculated on both full-time and part-time workers. AWE includes all cash earnings of an employee which are received on a regular and recurring basis, such as ordinary time and overtime payments. The average value of AWE for 2004-05 was A$40,356.

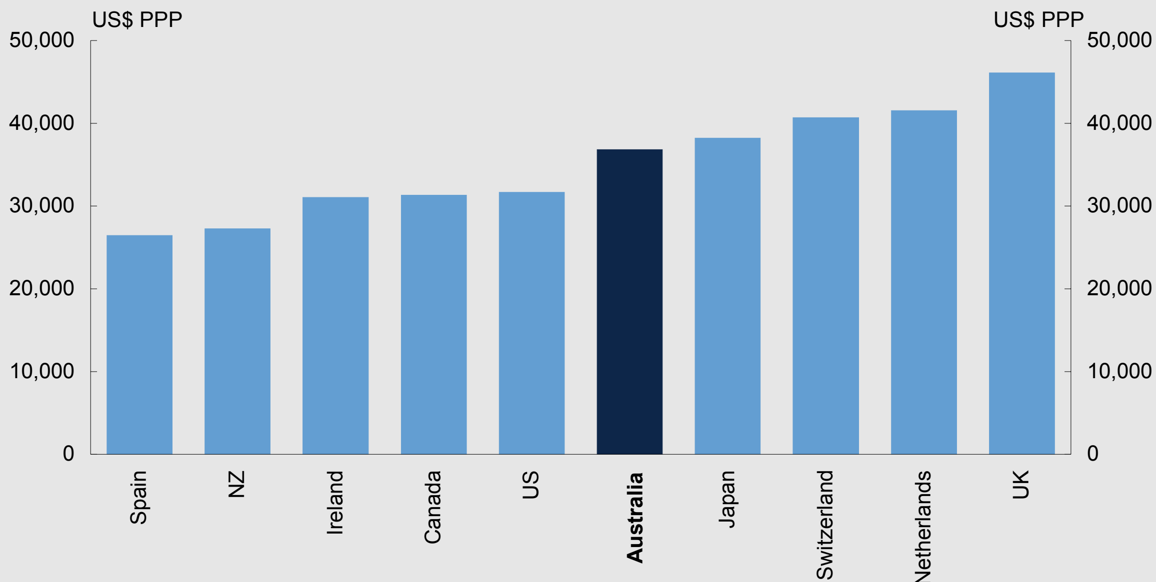
Male total average weekly earnings (MTAWE) is the same as AWE, but is calculated across males only. MTAWE has been used in the analysis in Chart 4.8 as it is the only wage series in Australia that is available back to 1960s. In 2004-05, MTAWE was around A$48,056.

Chart 4.8 shows the average wage across the OECD-10 on a purchasing power parity basis.

2 The average gross wage of a person engaged in full-time manual or non-manual labour in industry sectors C-K (inclusive) in the international classification. For Australia these sectors are: manufacturing, electricity gas and water, construction, wholesale trade, retail trade, accommodation, cafes and restaurants, transport and storage, communication services and finance and insurance.

Box 4.2: Measures of wage earnings (continued)

Chart 4.8: Gross wage earnings for an average worker
OECD-10, 2005 (US dollars)



Source: OECD *Taxing Wages*, 2005.

4.3 Description of tax rates

This section sets out the key attributes of the rate schedules for personal income tax, social security contributions and payroll taxes. The rates for the various components of wage and salary taxation impact on the tax wedge analysis.

4.3.1 Personal income tax rates

All of the OECD-10 have progressive personal income tax rates (that is, the average tax rate rises with income) with multiple rates and thresholds (progressivity is covered in greater detail in section 4.5).

Australia's personal income tax system is progressive through the application of the A$6,000 tax free threshold and marginal tax rates for graduated levels of income. In addition, the low income tax offset ensures low income taxpayers with income up to A$21,600 have a tax free threshold of A$7,567 in 2005-06.

Based on available information, at least three of the OECD-10 automatically index their national income tax thresholds to inflation each year (Canada, the Netherlands and the United States). Canada introduced indexation of national income tax thresholds in 2000. Thresholds are indexed by the increase in the consumer price index for the period ending on 30 September of the preceding taxation year. The Netherlands indexes for inflation at the beginning of each year. The United States indexes its tax thresholds annually to inflation. Most US states do not index their tax thresholds.

Other countries do not appear from the available information to have automatic indexation based on a legislative requirement to increase thresholds in line with inflation each year and instead rely on discretionary regular adjustments or other adjustment systems. Switzerland is required to make an adjustment after the cumulative inflation rate has increased by at least seven per cent since the last adjustment. Spain indexes its tax thresholds at 2 per cent to mitigate the effects of inflation. The United Kingdom also indexes thresholds by the increase in the retail price index unless the Parliament specifies this is not to occur.

In addition to national taxes, based on available information, four of the OECD-10 levy income tax on a sub-national basis (Canada, Japan, Switzerland and the United States). Analysis of the overall personal tax burden must take into account these taxes (national and sub-national tax rate schedules are documented in Appendix 4.5). Sub-national taxes may include state or provincial taxes as well as taxes levied at a local or municipal level.

The effect of the personal income tax rates for all levels of government is included in the tax wedge analysis.

4.3.2 Social security contributions rates

Social security contributions are payments to institutions of general government that are earmarked to provide social security benefits.

Examples of social security benefits funded through social security contributions include: unemployment insurance benefits and supplements; accident, injury and sickness benefits; old-age, disability and survivors' pensions; family allowances; reimbursements for medical and hospital expenses and provision of hospital or medical services.

Social security contributions are usually levied on both employees and employers and there are generally separate contributory structures for different types of schemes. Generally social security contributions are levied as a function of gross earnings, payroll or the number of employees.

Social security contributions are generally imposed at a flat rate, however they can be progressive or regressive. They are generally applied up to a maximum level.

Rates and maximum levels vary greatly between countries which makes comparisons difficult (detailed information is contained in Appendix 4.5 in local denomination).

The OECD reports (OECD 2001) that while income taxes are progressive in all OECD countries, employee social security contributions are either neutral or regressive, particularly at high income levels.

4.3.3 Payroll tax rates

Payroll taxes are levied on a similar basis to social security contributions and as such classified as a tax on labour. While robust incidence analysis is extraordinarily difficult, it is widespread practice to assume that taxes levied in respect of remuneration are ultimately borne by the employee.

Unlike employer social security contributions, payroll taxes are not collected for the specific purpose of funding social security programmes.

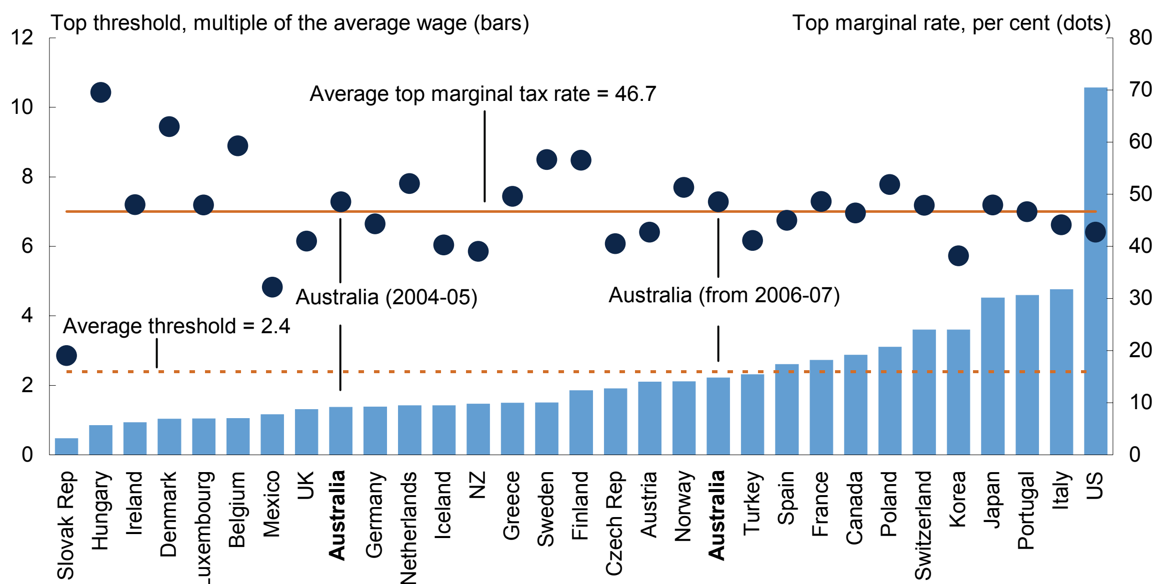
Payroll taxes can be paid by employers, employees or the self-employed either as a proportion of payroll or as a fixed amount per person.

4.4 TOP MARGINAL TAX RATE

Chart 4.9 shows the top marginal tax rate[3] for all OECD countries and the threshold to which the top marginal tax rate applies. The top marginal tax rate threshold is expressed as a multiple of the OECD's measure of average wages (see Box 4.2).

Chart 4.9: Top marginal tax rates and thresholds (unweighted averages)

OECD-30, 2005



Source: OECD Tax Database (preliminary data).

In 2004-05 Australia's top marginal tax rate applied to incomes over A$70,000. This equated to around 1.4 times average wages. The top marginal tax rate in 2006-07 will apply to incomes over A$125,000. This equates to around 2.2 times average wages. Australia's top marginal tax rate is 48.5 per cent (including the Medicare levy). Chart 4.9 includes unweighted OECD-30 averages for the top marginal tax rate and the top threshold. The unweighted OECD-30 average threshold is 2.4 times average wages and the unweighted OECD-30 average top marginal tax rate is 46.7 per cent.

Australia's top marginal tax rate is eleventh highest in the OECD-30. The threshold to which Australia's top rate applies is currently ninth lowest in the OECD-30. However, changes to the threshold from 1 July 2006 will result in Australia's ranking moving to twelfth highest in the OECD-30.

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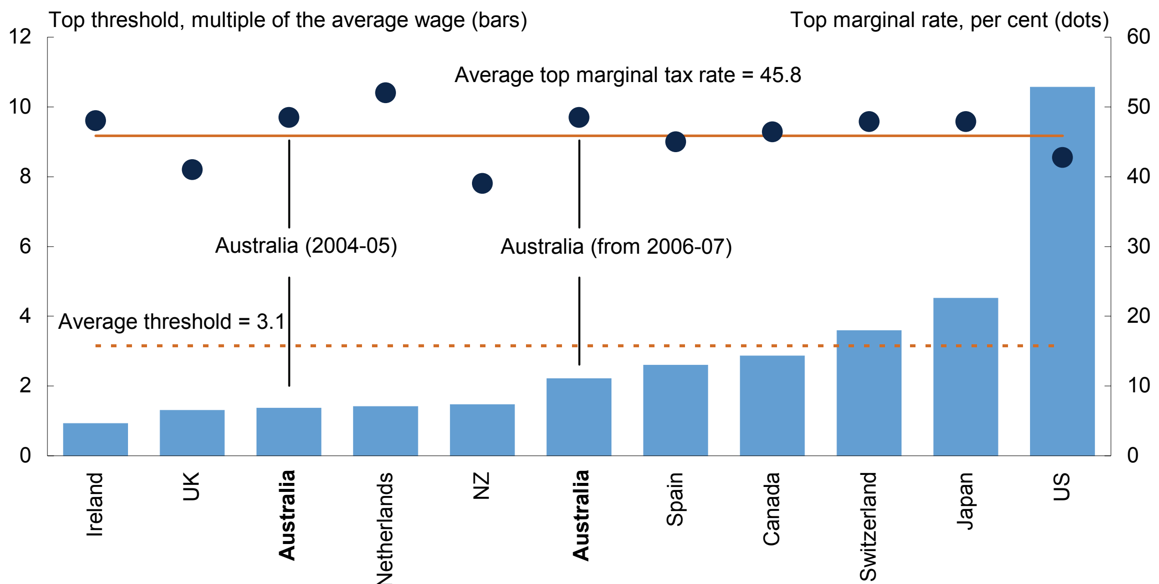
3 The top marginal tax rate is the all-in top marginal tax rate as calculated by the OECD. The all-in top marginal tax rate includes national and sub-national government personal income tax, plus employee social security contributions (as well as the impact of deductibility of social security contributions from national government taxes), resulting from a unit increase in gross wages.

Chart 4.10: Top marginal tax rates and thresholds (unweighted averages)
OECD-10, 2005

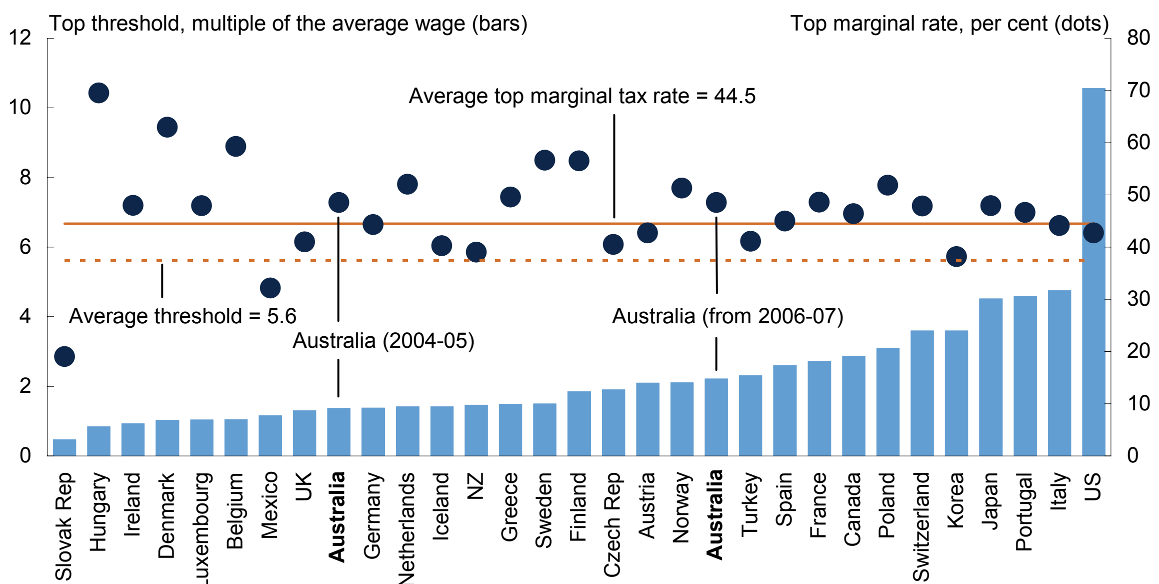


Source: OECD Tax Database (preliminary data).

Chart 4.10 isolates the top marginal tax rate and threshold for only the OECD-10. The unweighted average threshold is 3.1 times average wages and the unweighted average top marginal tax rate is 45.8 per cent.

Chart 4.11 replicates Chart 4.9 but uses GDP OECD-30 weighted averages rather than OECD-30 unweighted averages.

Chart 4.11: Top marginal tax rates and thresholds (weighted averages)
OECD-30, 2005



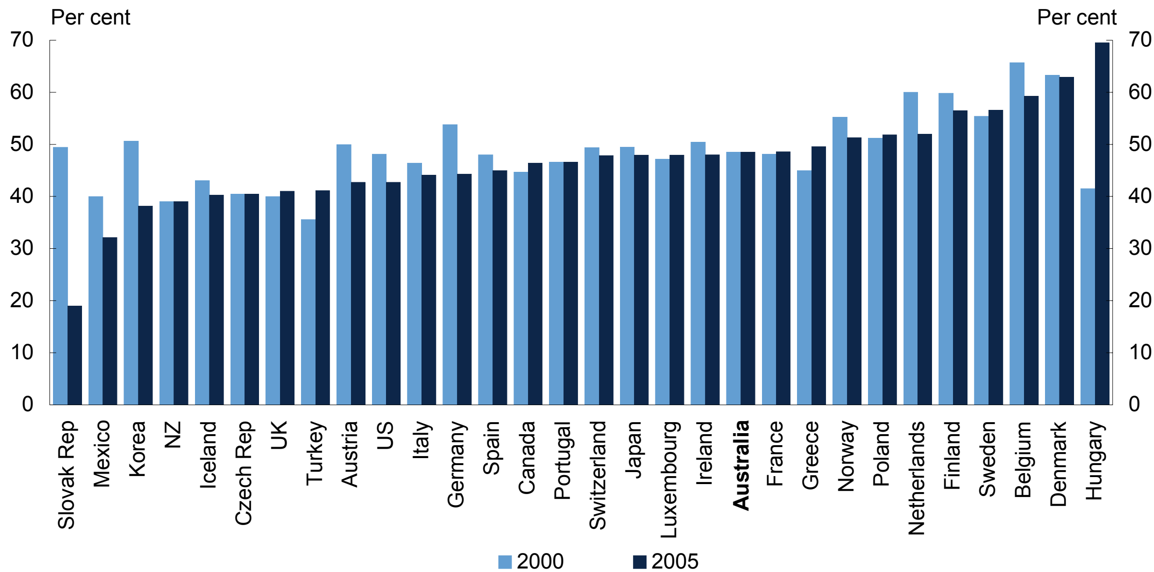
Source: OECD Tax Database (preliminary data).

The weighted average threshold is 5.6 times average wages. Chart 4.11 illustrates the significance of the United States when computing a measure of weighted averages as the

weighted average threshold is higher than the individual threshold for every other OECD country.

Chart 4.12 shows the change in the top marginal tax rate for the OECD-30 from 2000 to 2005.

Chart 4.12: Top marginal tax rates
OECD-30, 2000 and 2005

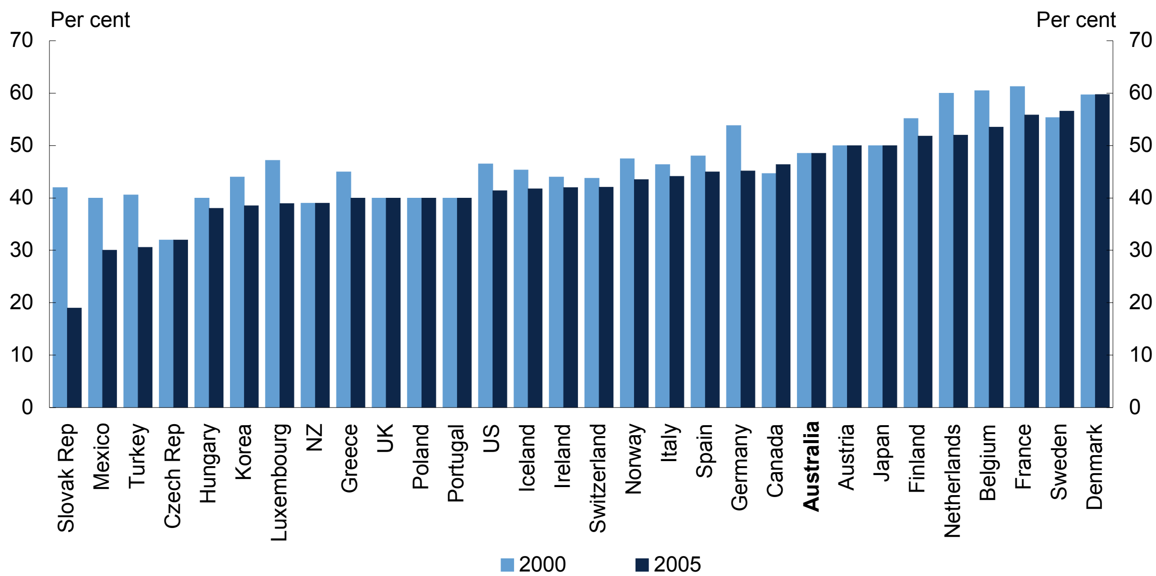


Source: OECD Tax Database (preliminary data).

Since 2000, seventeen countries in the OECD-30 have reduced their top marginal tax rate by varying magnitudes. This includes six countries in the OECD-10. Nine countries in the OECD-30 have increased their top marginal tax rate including two of the OECD-10. Australia is one of four countries in the OECD-30 that has not changed the top marginal tax rate (one of two in the OECD-10).

Chart 4.13 shows the change in the top *statutory* marginal tax rate for the OECD-30 from 2000 to 2005. The statutory rate is a partial measure that only includes the combined national and sub-national personal income tax rates. It does not include employee social security contributions.

Chart 4.13: Top statutory marginal tax rate
OECD-30, 2000 and 2005



Source: OECD Tax Database (preliminary data).

Since 2000, nineteen countries in the OECD-30 have reduced their top statutory marginal tax rate by varying magnitudes. This includes five OECD-10 countries. Only two countries in the OECD-30 increased the top statutory marginal tax rate (only one in the OECD-10). Australia is one of nine countries in the OECD-30 that has not changed the top statutory marginal tax rate (one of four in the OECD-10).

Charts 4.12 and 4.13 are limited to changes in marginal tax rates and do not consider movements in thresholds. In Australia's case, the threshold to which the top marginal tax rate applies has increased from A$50,000 in 1999-00 to A$70,000 in 2004-05 and will move to A$125,000 in 2006-07.

Box 4.3: Australia-United States comparison[4]

Calculating the tax wedge can be highly dependent on the location of the individual even within a country.

A highly stylised cameo that illustrates the difference in the tax wedge across and within countries is to compare a single high-income earner in Sydney to a single high-income earner in New York, Los Angeles and Houston.

The results in the table below illustrate the importance of taking into consideration all elements of the tax wedge when making international comparisons.

An analysis of the tax wedge includes the impact of federal, state, and city income taxes, social security contributions, the Medicare levy and payroll taxes. The analysis allows for state and local taxes to be claimed as a deduction from United States federal income tax. United States taxpayers are also entitled to a 'personal exemption' on their federal income tax. However, the analysis does not take into consideration the full range of deductions, such as work related deductions, that are available to the taxpayer in each country.

All-in tax wedge — single individual, no dependants

Income A$	Australia — Sydney resident 2006-07 (per cent)	United States — New York city resident 2006-07 (per cent)	United States – Los Angeles resident 2006-07 (per cent)	United States – Houston resident 2006-07 (per cent)
100,000	34.9	38.2	36.8	30.7
125,000	37.2	39.8	38.7	32.4
150,000	39.6	39.6	38.5	32.1

Source: Australian Treasury calculations; United States Revenue Service; New York State Department of Taxation and Finance; Californian Franchise Tax Board; Texas Workforce Commission.

4 Rates, thresholds and deductions for the New York state and city analysis are based on the latest information. However, New York State's budget is currently under negotiation and some items could change retroactively for tax year 2006. Calculations for Los Angeles are based on the latest Californian tax rates in 2005 (2006 rates are not available until August). Texas does not levy state personal income tax.

Box 4.4: Flat income tax systems in Eastern Europe

Over the past ten years there has been an increase in the number of flat income tax systems, especially in Eastern Europe. Flat income tax systems have been adopted in Estonia (1994), Lithuania (1994), Latvia (1995), Russia (2001), Serbia (2003), Slovakia (2004), the Ukraine (2004), Georgia (2005) and Romania (2005).

A pure flat income tax system taxes income at the same percentage rate along the full range of income. Most countries that have a flat income tax system also have either tax credits or a tax free threshold which adds a degree of progressivity to the system.

The main reasons that flat income tax rate systems have been adopted in Eastern Europe are:

- to encourage higher compliance with the tax system. Tax administration in some economies was extremely weak, with significant informal economic activity outside the tax system;
- to reduce complexity. Many of the economies in Eastern Europe that have adopted flat income taxes had various taxes at a range of rates that made it difficult for taxpayers to understand their tax obligations; and
- as part of broader tax reform to join the European Union.

Economies that have adopted flat income tax systems tend to have high levels of social security contributions. In many of the Eastern European economies social security contributions are the main element of the tax burden on labour.

The effect of introducing a flat income tax system on the tax burden can be illustrated by considering the experience in the Slovak Republic. This is the only 'flat tax country' in Eastern Europe that is a member of the OECD and as such is the only economy where OECD data are available on the tax wedge. The taxation of labour income in the Slovak Republic is similar to other Eastern European economies as social security contributions greatly exceed personal income taxation revenue.

In 2003, the personal income tax system in the Slovak Republic had five income brackets, with tax rates varying from 10 per cent to 38 per cent. A taxpayer on average earnings would face a marginal tax rate of 20 per cent. The corporate tax rate was 25 per cent, while the VAT rate was 20 per cent. In 2004, all of these rates were replaced with a flat tax rate of 19 per cent. The introduction of the flat rate was combined with a large increase in the basic allowance (it was more than doubled) and the removal of many forms of tax relief which led to a broadening of the tax base.

Box 4.4: Flat income tax systems in Eastern Europe (continued)

Table 4.1 compares average income tax rates and the tax wedge for a single individual in 2003 and 2004 (before and after the introduction of a flat tax system) for different percentages of average earnings. Despite the introduction of a flat income tax system, there have only been small changes in the tax wedge facing individuals for different income levels (see Table 4.1).

Table 4.1: Average income tax and tax wedge for a single individual before and after Slovak reform (2003 versus 2004)

	67% of average wages		100% of average wages		167% of average wages	
	2003	2004	2003	2004	2003	2004
Income tax (per cent)	4.8	3.7	6.3	7.9	10.7	11.3
Tax wedge (per cent)	40.3	38.8	41.4	42.0	44.6	44.5

Source: OECD *An International Perspective on Japanese Tax Reform*, 2006.

Russia also introduced a flat income tax system in 2001. A single 12 per cent rate replaced a progressive schedule with rates of 12, 20 and 30 per cent; various exemptions from tax were eliminated; social security contribution rates were reduced; and the maximum tax free threshold was increased. As Russia is not a member of the OECD there is no comparative tax wedge data available to analyse the net effect of these changes.

4.5 PROGRESSIVITY

Progressivity measures the extent to which the income tax burden increases with income. Hence a more progressive tax system would have people on higher incomes paying a higher proportion of their income in tax than people on lower incomes.

Progressive personal income tax systems reflect the redistributive role played by governments. Progressive taxes are characterised by an increasing average rate of tax as income rises. As such (and in the absence of negative taxes), the marginal personal income rate of tax must lie above the average rate of tax.

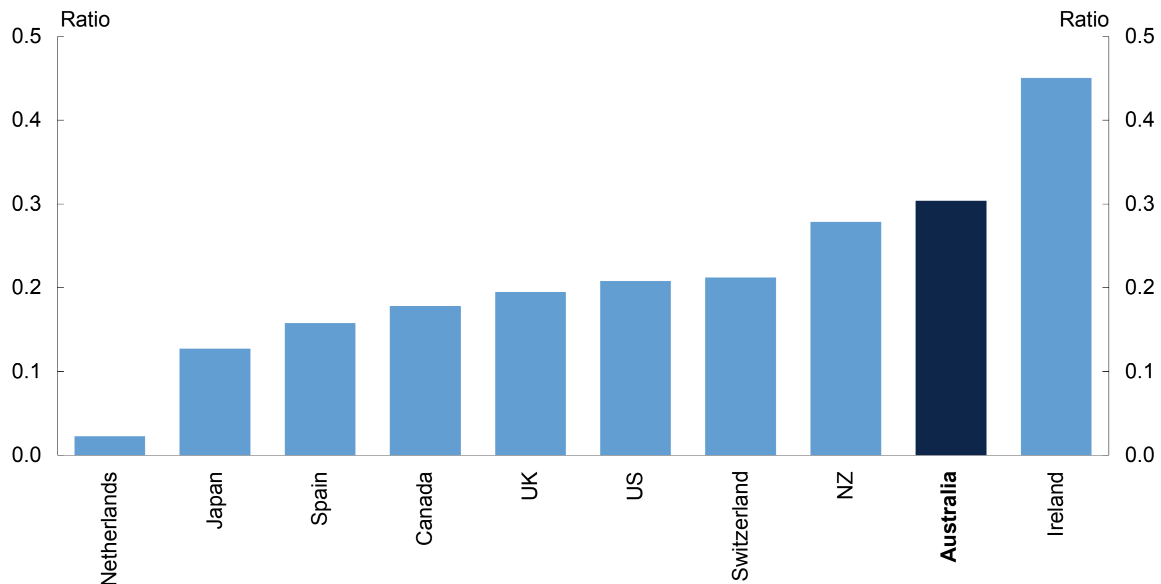
However, it should be noted that progressivity does not in itself equate to equity. A progressive system may not be equitable if it results in a large number of higher income earners avoiding or evading taxes. The measure of progressivity discussed below is only relevant to questions of vertical equity. More broadly the progressivity of a tax system does not measure the equity of various expenditures. Lastly, a more progressive tax and welfare system generally results in higher effective marginal tax rates.

There are different measures of progressivity which vary in complexity. It is beyond the scope of this study to provide an in-depth analysis of these methods.

The OECD (OECD 2006) has developed a simple measure of determining progressivity. Using this methodology Chart 4.14, compares the progressivity of the tax wedge for a single

individual with no dependants on 67 and 167 per cent of average wages.[5] Higher numbers indicate higher progressivity.

Chart 4.14: Progressivity between 67 and 167 per cent average wages[(a)]
OECD-10, 2005



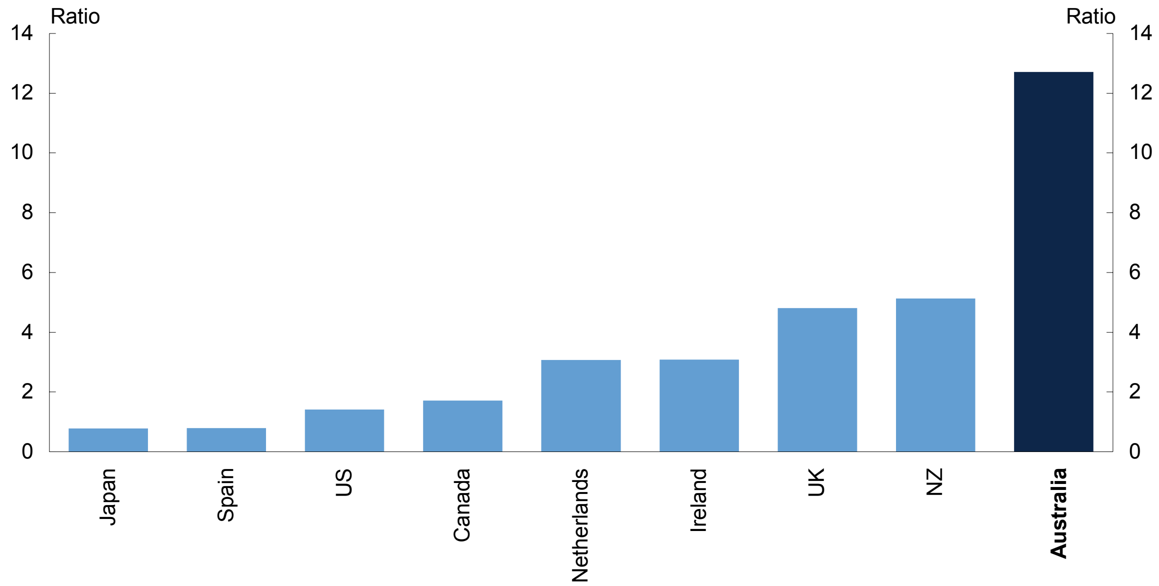
(a) Comparison for a single worker with no dependants.
Source: OECD *Taxing Wages*, 2005.

On this measure, Australia has the second most progressive tax system in the OECD-10 after Ireland for single incomes between 67 per cent of average wages and 167 per cent of average wages.

An OECD report (Whiteford 2005) shows that, of the 24 OECD countries considered in this study, Australia has the most progressive distribution of benefits on two different measures (Chart 4.15). This is the result of the relatively tightly targeted nature of Australia's welfare system. The study also calculates a measure of churning (the notion that households can be both recipients of welfare and taxpayers simultaneously) across OECD countries where data were available. The results shows that Australia has the lowest level of churning across those countries.

5 Progressivity between 67 to 167 per cent average wages is calculated by $((T_{167}-T_{67})/T_{167})$ where T_{167} is the tax wedge at 167 per cent average wages and T_{67} is the tax wedge at 67 per cent average wages.

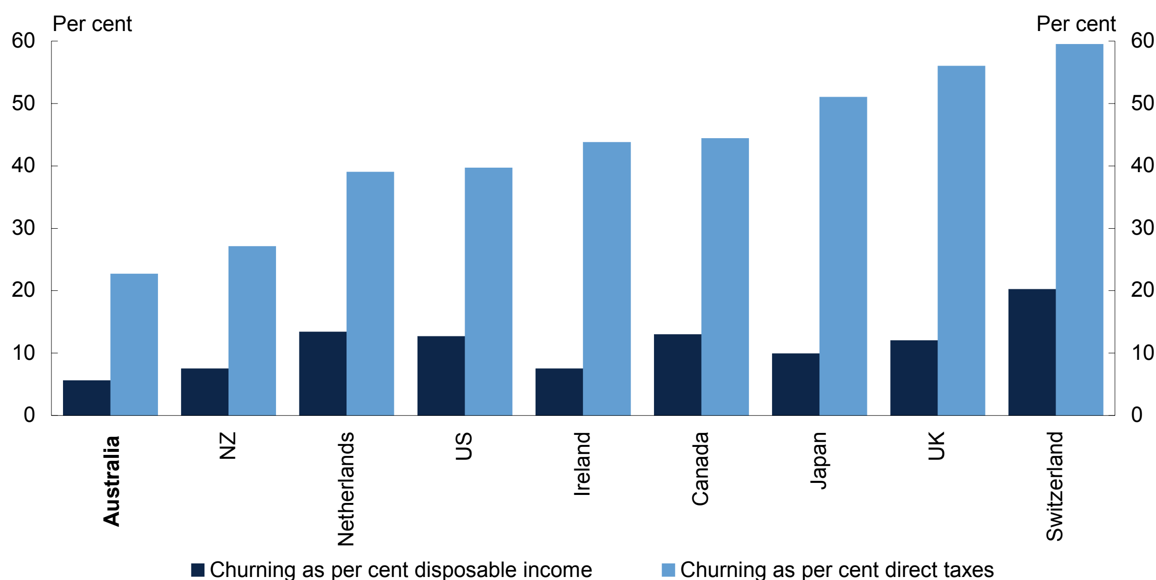
Chart 4.15 shows progressivity of transfers through a ratio of the benefits received by the poorest quintile to benefits received by the richest quintile for the total population for the OECD-10.



Source: Whiteford, OECD (2005).

Chart 4.16 shows Whiteford's measure of churning[6] as a percentage of household disposable income and as a percentage of direct taxes. In both measures Australia has the lowest level of churn. Caution should be exercised when interpreting these results as the tax mix within a country can significantly affect the results. For example, countries with a high reliance on indirect taxes will have a high percentage of churn as a percentage of direct taxes.

Chart 4.16: Measures of churn
Sub-set of OECD-10, 2000[(a)]



(a) Data on Spain not available.
Source: Whiteford, OECD (2005).

4.6 Effective marginal tax rates

Effective marginal tax rates measure the percentage of a one dollar increase in income that is lost to income tax and income tests on government payments and services.

Appendices 4.1 and 4.2 detail results for the marginal tax wedge and the net personal marginal tax rate which are measures of effective marginal tax rates at specified income levels.

The results show that Australia's marginal tax wedge and net personal marginal tax rate are generally relatively higher than the other OECD-10 countries. Again this is the result of the relatively tightly targeted nature of Australia's welfare system.

Effective marginal tax rates can also be adjusted to take account of other factors that influence the decision to enter the workforce. One factor is child care which is considered in Box 4.5.

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6 Churning is calculated by comparing the level of transfers by each decile with the level of direct taxes (income taxes and employee social security contributions) paid by each decile. Where transfers exceed taxes, the churning is the level of taxes and where taxes exceed transfers, churning is the level of transfers. This measure of churning only counts direct financial transfers, not indirect transfers through subsidised services such as health and education.

Box 4.5: Child care

A range of different measures are used to provide assistance for families who use child care. These measures can be delivered either through the tax system or through direct payments.

In some countries, child care payments are tax deductible. This approach can reduce the progressivity of the tax system. Other countries use tax credits and direct payments such as child care-related means-tested payments. These payments tend to be targeted towards low-income families or socially disadvantaged groups such as sole parents and are progressive because they are higher at lower levels of income. Support is sometimes available for parents caring for their own children at home (home-care or child-raising allowances).

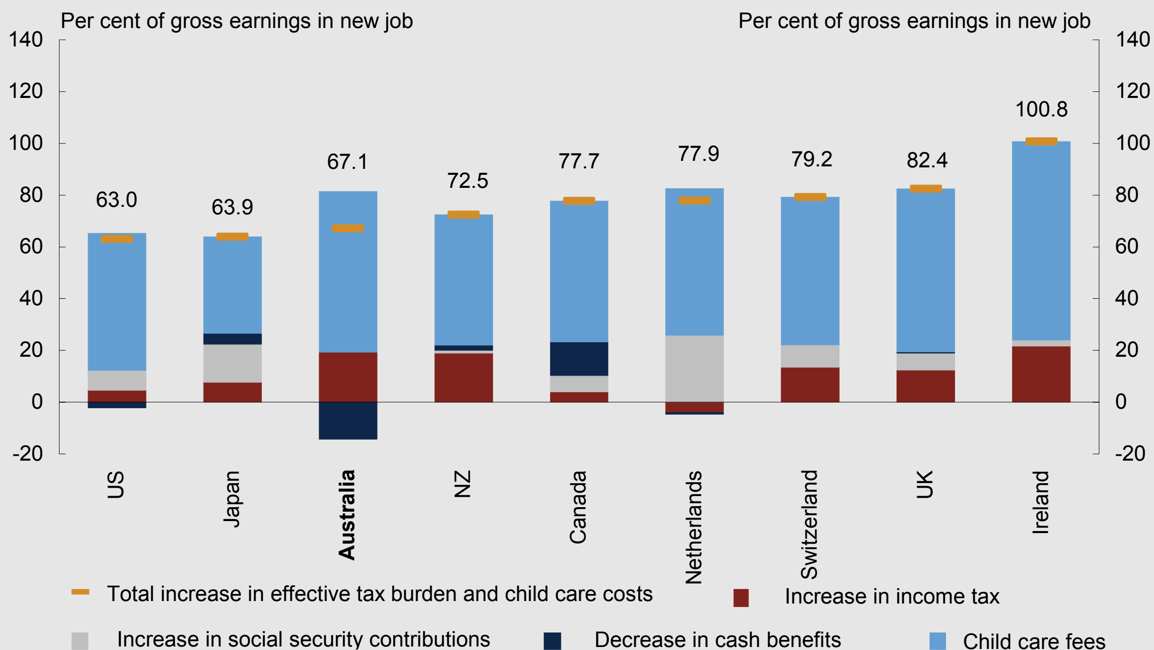
Some countries, including Australia, use a combination of tax and direct payments. For example, Australia provides assistance through the Child Care Benefit (a means-tested payment) and the Child Care Tax Rebate (a non-refundable tax credit).

The OECD quantifies (OECD 2005) the net cost of purchasing centre-based child care (including the impact of child care related tax concessions and cash benefits available to parents) and provides an estimate of the effective tax burden including child care costs.

Chart 4.17 shows secondary earners and sole parents in Australia have the third lowest increase in the effective tax burden (including child care costs) as a per cent of gross earnings when starting a new job compared to the OECD-10. The effective tax burden includes the effect of income taxes, employees' social security contributions, cash benefits as well as child care costs.

Chart 4.17: Effective tax burden including child care costs for secondary earner

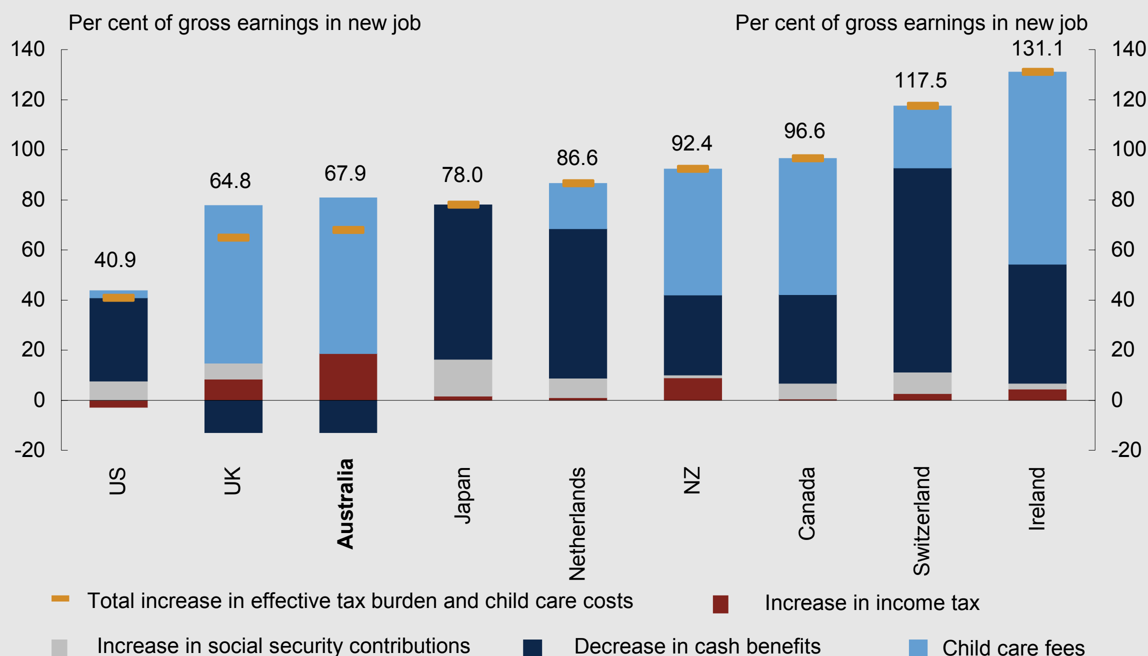
Sub-set of OECD-10, 2002[(a)]



(a) Data on Spain not available.
Source: OECD (2005).

Box 4.5: Child care (continued)

Chart 4.18: Effective tax burden including child care costs for sole parent
Sub-set of OECD-10, 2002[(a)]



(a) Data on Spain not available.
Source: OECD (2005).

This analysis is based on 2002 data and as such does not reflect recent policy initiatives, including in Australia's case the Child Care Tax Rebate.

4.7 Description of the tax base

Personal income tax systems are founded on an income base. Typically, a country's assessable personal income base may include the following items: wages; salaries; allowances; tips; capital income (dividends, capital gains, interest payments and royalties); rents; partnership income; distribution from trusts; fringe benefits; imputed rents from owner-occupied housing; and income transfers (pensions, disability compensation, unemployment benefits and sick pay).

The majority of the OECD-10 include fringe benefits in the taxable income base. Nonetheless, most countries have a number of concessions and exclusions for fringe benefits in the tax base. Australia and New Zealand are the only two countries in the OECD-10 that levy a separate fringe benefits tax (see Appendix 4.5).

To calculate taxable income, assessable income is reduced by deductions. Deductions can be broadly categorised into personal allowance deductions and specific deductions.

Personal allowance deductions

Personal allowance deductions are provided on the basis of the individual's family situation rather than their financial situation.

In many of the OECD-10, a personal allowance is provided with higher amounts paid to married couples with dependants. Personal allowances are provided in Ireland, Japan, the Netherlands, Spain, Switzerland, the United Kingdom and the United States.

An alternative to a personal allowance deduction is a tax free threshold. Australia has a tax free threshold rather than a personal allowance.

In addition, countries may operate a system of tax credits (or offsets) which are applied against a person's tax liability rather than their income. In Canada a basic credit reduces a person's tax liability but is available to all individuals and as such is equivalent to a tax free threshold.

Specific deductions

The majority of the OECD-10 countries allow for work-related deductions that are directly related to gaining or producing assessable income.

Table 4.2: Deduction for work-related expenses for OECD-10

Country	Work-related expenses	Comment
Australia	Yes	Directly related to gaining or producing an employee's assessable income.
Canada	Limited	Only deductions specifically legislated are allowed, for example, accounting and legal fees are allowable deductions.
Ireland	Yes	Expenses incurred wholly, exclusively and necessarily in the performance of duties.
Japan	Limited	Specific deductions which exceed the standard deduction for employment income are allowed. Specific deductions include travelling expenses.
Netherlands	Yes	All expenses which are necessary to collect or maintain income.
New Zealand	Limited	Condition excludes expenditure that is of a capital nature, private, nature, exempt income, and non-residents' foreign-sourced income nature, and also limits employment expenses due to withholding taxes.
Spain	No	Only a general standard deduction is available. Expenses relating to employment are generally not deductible.
Switzerland	Yes	
United Kingdom	Yes, conditional	Most deductions in the United Kingdom must be incurred wholly, exclusively and necessarily in the performance of an employee's duties, a condition that precludes the deduction of many employment related expenses.
United States	Yes	Employees can deduct work-related expenses subject to limitation (expenses generally only deductible to the extent they exceed 2 per cent of adjusted gross income). The United States allows taxpayers the option of claiming a standard deduction in lieu of itemising deductions.

Many of the OECD-10 that levy social security contributions also allow this expense as a deduction. The United States also allows individuals to claim state and local taxes as a deduction from their federal income tax.

Tax unit

The tax unit can be based on an individual or on a person's spouse and dependants.

While the majority of the OECD-10 countries have the individual as the tax unit, joint taxation is possible in Canada, Spain, Ireland, Switzerland and the United States. According to the OECD (OECD 2006) the only countries in the OECD-10 where couples with average earnings can benefit from joint taxation are Ireland, Switzerland and the United States.

Australia's personal income tax system is based on the individual. There are a few areas of personal income tax that are based on the combined family income. For example, the Australian Government levies a Medicare levy surcharge for individuals who do not have private health insurance and whose family income exceeds the relevant threshold. Family income, for Medicare levy surcharge purposes only, includes the income of both the taxpayer and their spouse.

Appendix 4.5 provides more detail on the tax base and the tax unit for each of the OECD-10.

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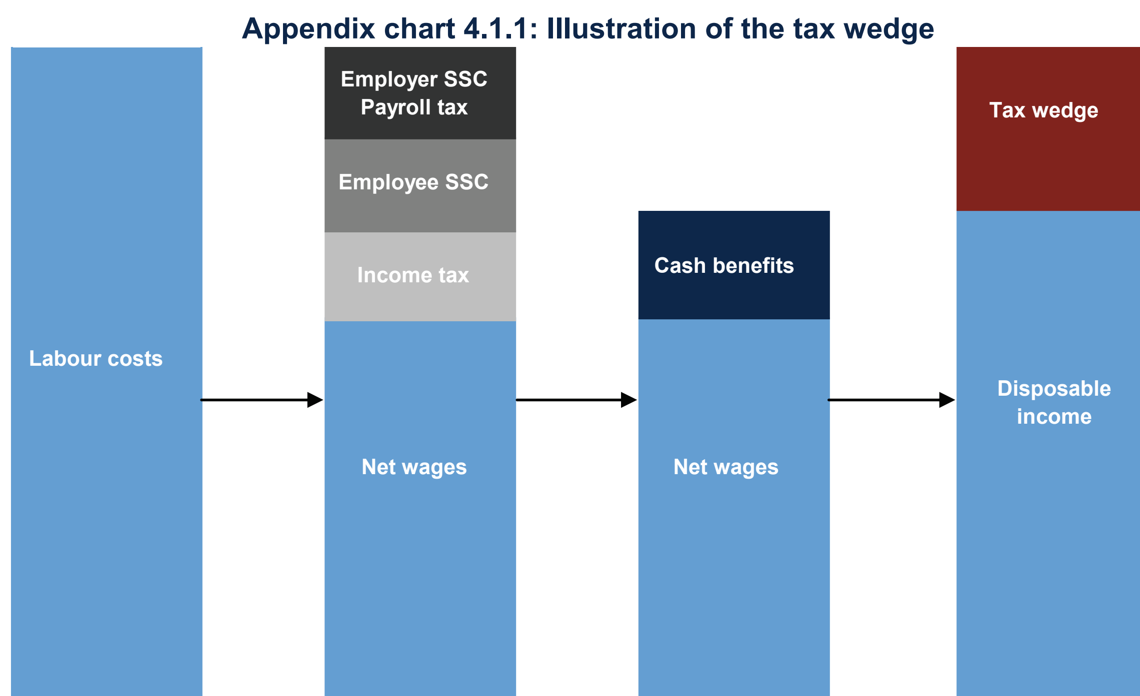
APPENDIX 4.1: TAX WEDGE ANALYSIS

TAX WEDGE ANALYSIS

The tax wedge is the sum of personal income tax (at all levels of government), employee and employer social security contributions and payroll taxes minus any cash benefits from government welfare programmes. The tax wedge is usually expressed as a percentage of the total labour costs. This measure is illustrated diagrammatically in Appendix chart 4.1.1.

Appendix chart 4.1.1: Illustration of the tax wedge



The tax wedge is the most useful measure of the tax burden to consider because it takes into account the interchangeability of cash benefits and tax relief. The tax wedge for workers in Australia is consistently ranked amongst the lowest eight in the OECD-30 (Appendix table 4.1.3) for each of the eight family types considered later in this Appendix. Australia's tax wedges are among the lowest six of the OECD-10 for all the family types (Appendix table 4.1.4).

TAX WEDGE COMPOSITION

Appendix table 4.1.1 outlines the composition of the tax wedge for a single individual earning the average wage with no dependants. In general, the tax wedge consists of income tax, employee and employer social security contributions, payroll tax, and cash benefits. For simplicity, only the components of an average worker's tax wedge are examined. This illustrates that the composition of the tax wedge and the proportions of the components vary significantly amongst the OECD-30.

Appendix table 4.1.1: Tax wedge for a single worker earning the average wage with no dependants, 2005

Country	Total tax wedge	Income tax	Employee social security contributions	Employer social security contributions plus payroll tax	Labour costs in US dollars using purchashing pwer parities
Korea	17.3	2.5	6.5	8.2	41,086
Mexico	18.2	5.6	1.4	11.2	12,031
New Zealand	20.5	20.5	0.0	0.0	27,274
Ireland	25.7	11.4	4.7	9.7	34,395
Japan	27.7	5.9	10.5	11.3	43,122
Australia	28.3	22.7	0.0	5.7	39,062
Iceland	29.0	23.4	0.2	5.4	33,953
United States	29.1	14.6	7.3	7.3	34,144
Switzerland	29.5	9.6	10.0	10.0	45,191
Canada	31.6	14.8	6.2	10.5	34,965
United Kingdom	33.5	15.7	8.2	9.6	50,982
Luxembourg	35.3	11.1	12.3	11.9	46,531
Portugal	36.2	8.1	8.9	19.2	24,933
Norway	37.3	18.8	6.9	11.6	43,554
Slovak Republic	38.3	6.9	10.6	20.8	15,748
Netherlands	38.6	9.5	19.7	9.5	45,910
Greece	38.8	4.3	12.5	21.9	33,050
Spain	39.0	10.7	4.9	23.4	34,545
Denmark	41.4	30.2	10.6	0.5	38,664
Turkey	42.7	12.7	12.3	17.7	22,610
Poland	43.6	5.3	21.3	17.0	19,548
Czech Republic	43.8	8.6	9.3	25.9	20,559
Finland	44.6	20.1	5.1	19.4	43,443
Italy	45.4	13.6	6.9	24.9	36,011
Austria	47.4	10.9	14.0	22.6	47,692
Sweden	47.9	18.1	5.3	24.5	43,916
France	50.1	10.8	9.6	29.7	47,824
Hungary	50.5	14.3	10.0	26.3	18,559
Germany	51.8	17.3	17.3	17.3	53,278
Belgium	55.4	21.4	10.7	23.3	53,581
Unweighted average:					
OECD	37.3	13.3	8.8	15.2	36,205

Source: OECD *Taxing Wages*, 2005.

Analysis of the tax wedge for different family types

The OECD collects data on tax wedges for eight different hypothetical family types. These family types provide a broad representation of a large number of common circumstances. These eight cameos are summarised in Appendix table 4.1.2.

Appendix table 4.1.2: Characteristics of the different family types

Family type	Marital status	Number of children	Number of earners	First wage	Second wage
1	Single	0	1	67%	0%
2	Single	0	1	100%	0%
3	Single	0	1	167%	0%
4	Single	2	1	67%	0%
5	Married	2	1	100%	0%
6	Married	2	2	100%	33%
7	Married	2	2	100%	67%
8	Married	0	2	100%	33%

Source: OECD *Taxing Wages*, 2005.

Australia’s position for the eight family types

Appendix chart 4.1.2 and Appendix chart 4.1.3 show the tax wedge of the OECD-30 for the eight family types, with Australia's position highlighted. Australia is always ranked within the lowest eight amongst the OECD-30 for all the family types. Appendix chart 4.1.4 and Appendix chart 4.1.5 show the marginal tax wedge of the OECD-30 for the eight family types. The OECD averages and Australia’s rankings for the tax wedge and marginal tax wedge for the eight family types are summarised in Appendix table 4.1.3 to Appendix table 4.1.6.

The tax wedge for an average single worker in Australia is 28.3 per cent, which is the sixth lowest in the OECD-30 and is the fourth lowest in the OECD-10. New Zealand, Ireland and Japan have smaller tax wedges. Australia's marginal tax wedge for an average worker is 35.4 per cent, placing it sixth lowest in the OECD-30 and fourth lowest in the OECD-10.

Australia's tax wedge for a single worker earning 67 per cent of the average wage is 24.8 per cent, which is the sixth lowest in the OECD-30 and third lowest in the OECD-10. New Zealand and Ireland have smaller tax wedges. Australia's marginal tax wedge for this worker is 35.4 per cent, which is tenth lowest in the OECD-30 and fourth largest in the OECD-10. Among the OECD-10, the United Kingdom, Spain and the Netherlands have larger marginal tax wedges.

In Australia, the tax wedge for a single worker earning 167 per cent of the average wage is 35.6 per cent placing it eighth lowest in the OECD-30 and sixth lowest in the OECD-10. Australia’s marginal tax wedge for this worker is 51.4 per cent, which is sixteenth lowest in the OECD-30 and second largest in the OECD-10 after the Netherlands. Australia’s marginal tax wedge is slightly above the OECD-30 average.

Australia's tax wedge for a single parent earning 67 per cent of the average wage with two children is -5.5 per cent which is second lowest in the OECD-30 and the OECD-10 after Ireland. This means that the benefits received as cash transfers are larger than the total tax burden. New Zealand, the United States and Canada also provide a net benefit for this worker. The marginal tax wedge in Australia for this single parent is 68.3 per cent of labour

costs, which is the third largest in the OECD-30 after Belgium and the United Kingdom and is the second largest in the OECD-10.

The tax wedge in Australia for a single-income married couple earning the average wage with two children is 16.0 per cent of labour costs, which is the sixth lowest in the OECD-30 and fourth lowest amongst the OECD-10. Ireland has the lowest tax wedge for this family type. Australia's marginal tax wedge for this family type is 54.2 per cent, which is the tenth largest in the OECD-30 and the third largest in the OECD-10 after Canada and New Zealand.

In Australia, the tax wedge for a dual-income married couple with one partner earning 100 per cent and the other 33 per cent of the average wage with two children is 20.5 per cent, which is eighth lowest in the OECD-30 and fourth lowest amongst the OECD-10 countries. The United States, New Zealand and Ireland have lower tax wedges. Australia’s marginal tax wedge for this family type is 35.4 per cent which places Australia eighth lowest in the OECD-30 and sixth lowest in the OECD-10.

For a dual-income married couple with one partner earning 100 per cent and the other 67 per cent of the average wage with two children in Australia the tax wedge is 23.1 per cent, which is seventh lowest in the OECD-30 and fourth lowest in the OECD-10. Australia’s marginal tax wedge for this family type is 35.4 per cent which places Australia seventh lowest in the OECD-30 and fifth lowest in the OECD-10.

In Australia, a dual-income married couple with one partner earning 100 per cent and the other 33 per cent of the average wage with no children has a tax wedge of 25.2 per cent, which is sixth lowest in the OECD-30 and third lowest in the OECD-10 after New Zealand and Ireland. Australia’s marginal tax wedge for this family type is 35.4 per cent which places Australia eighth lowest in the OECD-30 and sixth lowest in the OECD-10.

In summary, Australia’s tax wedge is substantially closer to the OECD-10 average than the OECD-30 average. Of particular note is the tax wedge for a single parent earning 67 per cent of the average wage with two dependent children which is - 5.5 per cent. Spain, Netherlands, Switzerland and the United Kingdom generally have a higher tax wedge than Australia in all eight family scenarios. New Zealand and Ireland generally have a lower tax wedge than Australia for most family types.

Australia’s marginal tax wedge is above both the OECD-30 and OECD-10 averages for a single worker earning 167 per cent of the average wage with no children, a single parent earning 67 per cent of the average wage with two children and for a single income married couple earning the average wage with two children. For families with dependants, any high marginal tax wedges are a result of Australia’s relatively highly targeted social security system.

Appendix table 4.1.3: Australia's tax wedge — comparison with OECD-30

	Single no children 67%	Single no children 100%	Single no children 167%	Single 2 children 67%	Married 2 children 100%-0%	Married 2 children 100%-33%	Married 2 children 100%-67%	Married no children 100%-33%
Australia's tax wedge	24.8	28.3	35.6	-5.5	16.0	20.5	23.1	25.2
OECD-30 average tax wedge	33.7	37.3	42.1	19.0	27.7	30.0	32.4	34.3
Australia's rank in the OECD-30	6	6	8	2	6	8	7	6

Note: The country with the smallest tax wedge has a rank of one.
Source: OECD *Taxing Wages*, 2005.

Appendix table 4.1.4: Australia's tax wedge — comparison with OECD-10

	Single no children 67%	Single no children 100%	Single no children 167%	Single 2 children 67%	Married 2 children 100%-0%	Married 2 children 100%-33%	Married 2 children 100%-67%	Married 2 children 100%-33%
Australia's tax wedge	24.8	28.3	35.6	-5.5	16.0	20.5	23.1	25.2
OECD-10 average tax wedge	27.7	30.4	35.0	7.5	20.5	23.5	26.1	27.6
Australia's rank in the OECD-10	3	4	6	2	4	4	4	3

Note: The country with the smallest tax wedge has a rank of one.
Source: OECD *Taxing Wages*, 2005.

Appendix table 4.1.5: Australia's marginal tax wedge — comparison with OECD-30

	Single no children 67%	Single no children 100%	Single no children 167%	Single 2 children 67%	Married 2 children 100%-0%	Married 2 children 100%-33%	Married 2 children 100%-67%	Married no children 100%-33%
Australia's marginal tax wedge	35.4	35.4	51.4	68.3	54.2	35.4	35.4	35.4
OECD-30 average marginal tax wedge	43.0	46.5	49.2	46.7	46.8	44.5	45.5	44.6
Australia's rank in the OECD-30	10	6	16	28	21	8	7	8

Note: The country with the smallest marginal tax wedge has a rank of one.
Source: OECD *Taxing Wages*, 2005.

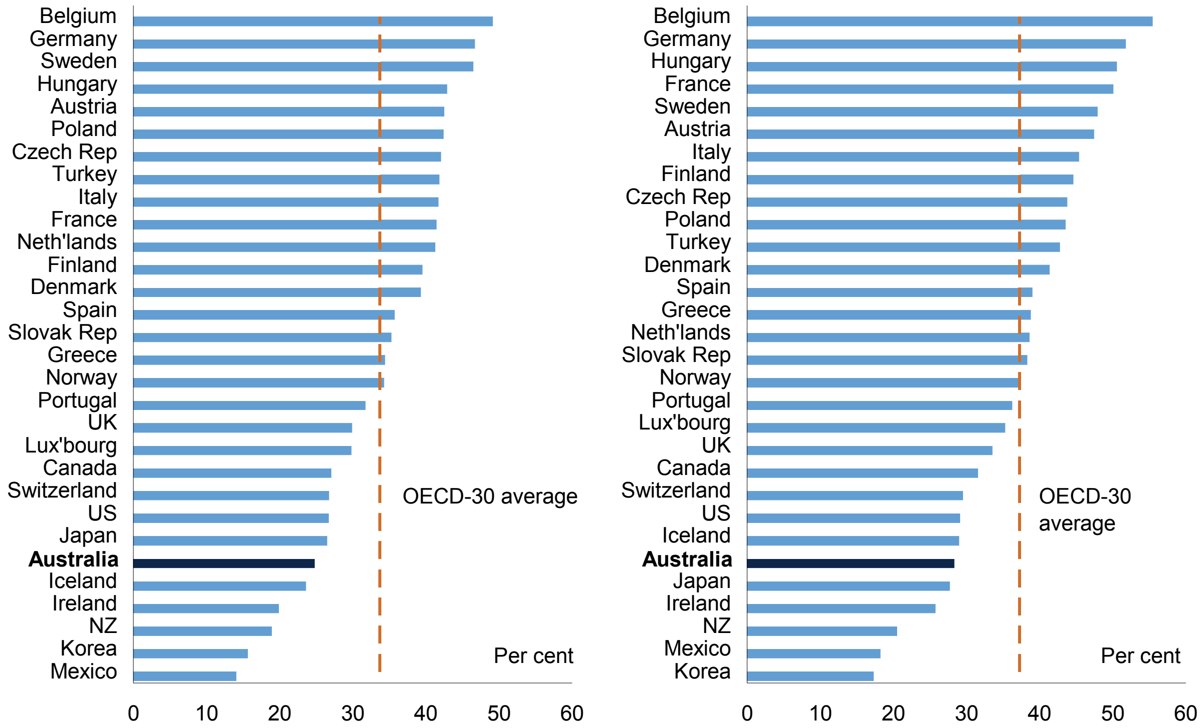
Appendix table 4.1.6: Australia's marginal tax wedge — comparison with OECD-10

	Single no children 67%	Single no children 100%	Single no children 167%	Single 2 children 67%	Married 2 children 100%-0%	Married 2 children 100%-33%	Married 2 children 100%-67%	Married no children 100%-33%
Australia's marginal tax wedge	35.4	35.4	51.4	68.3	54.2	35.4	35.4	35.4
OECD-10 average marginal tax wedge	36.8	40.1	43.0	48.2	45.4	38.0	38.4	38.0
Australia's rank in the OECD-10	7	4	9	9	8	6	5	6

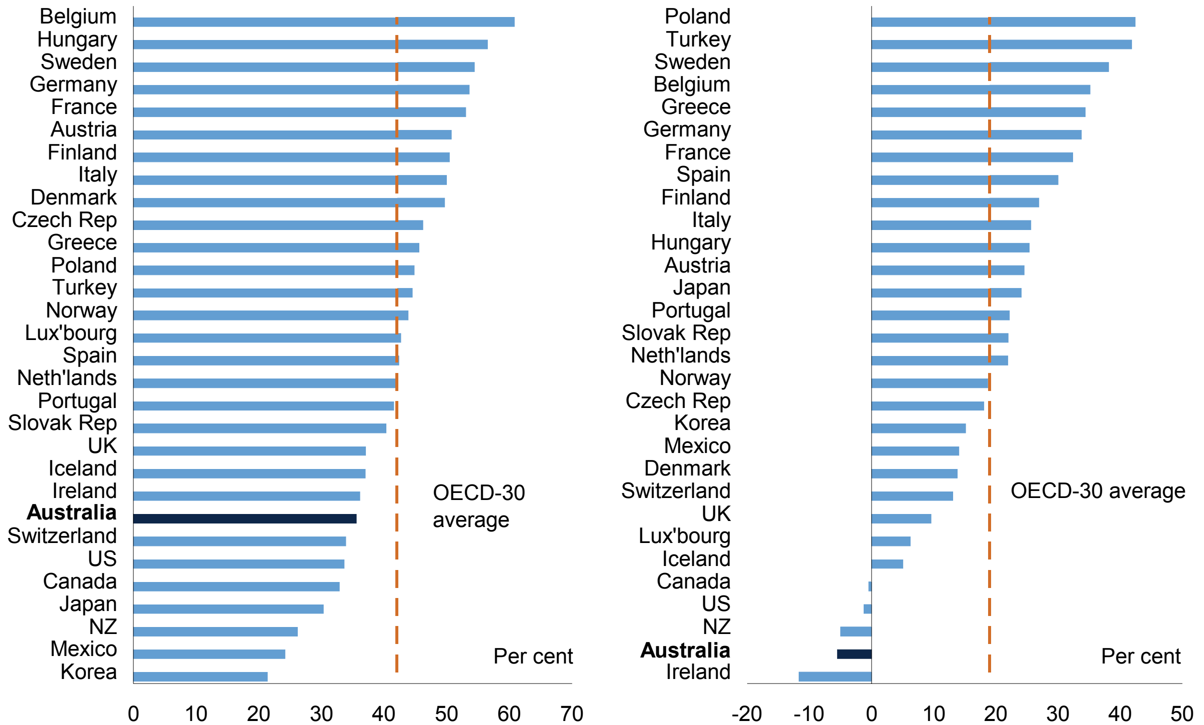
Note: The country with the smallest marginal tax wedge has a rank of one.
Source: OECD *Taxing Wages*, 2005.

Appendix chart 4.1.2: Tax wedge (as a percentage of labour costs) for singles

Tax wedge for a single worker earning 67 percent of the average wage with no children (left) and for an average worker with no children (right), OECD-30



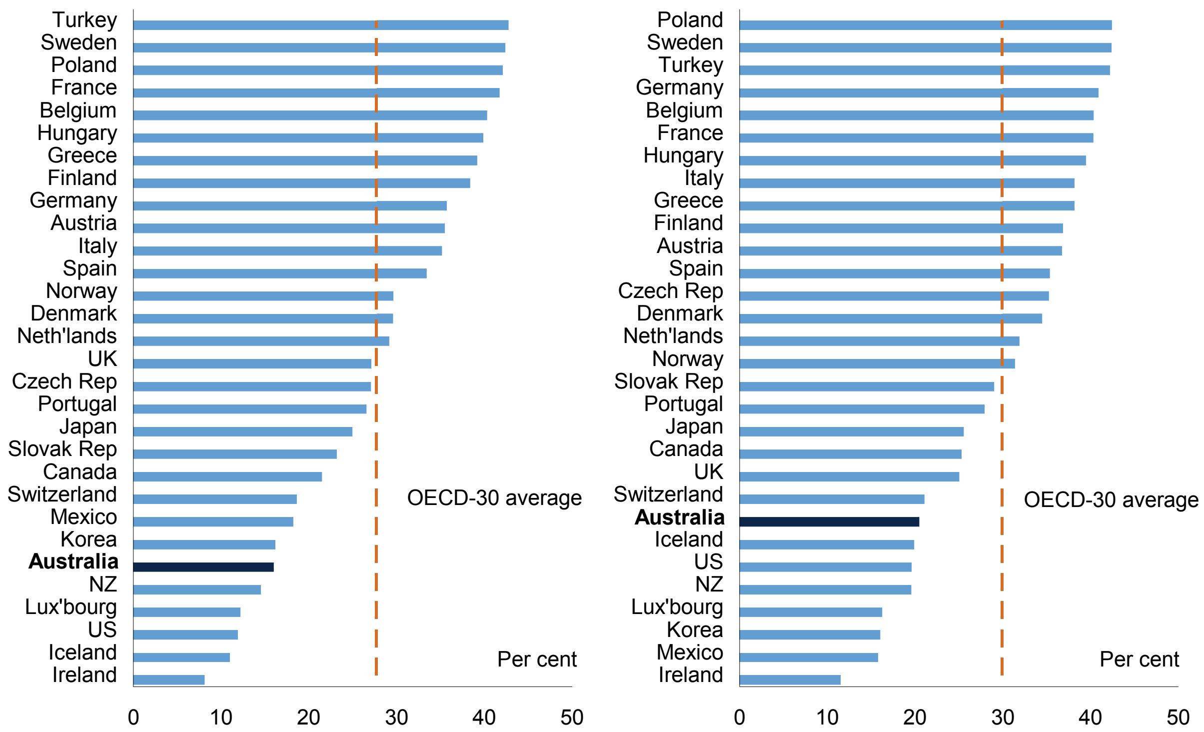
Tax wedge for a single average worker earning 167 per cent of the average wage (left) and for a single parent earning 67 per cent of the average wage with two children (right), OECD-30



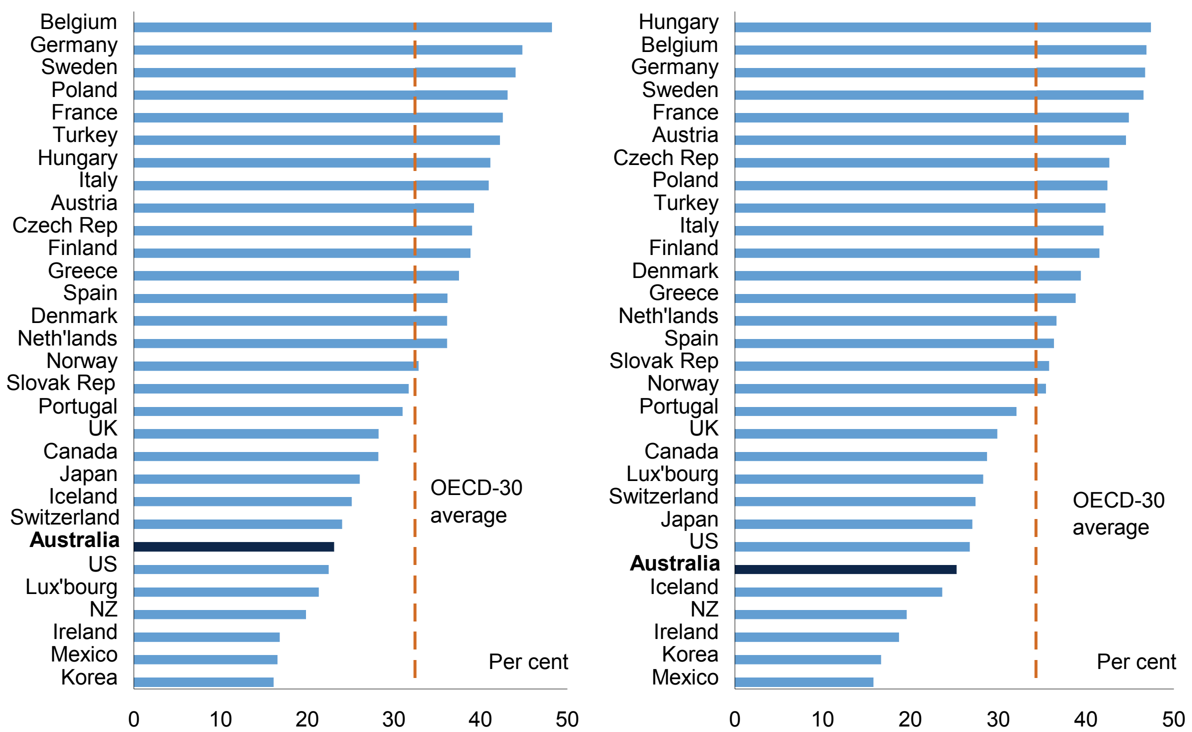
Source: OECD *Taxing Wages*, 2005.

Appendix chart 4.1.3: Tax wedge (as a percentage of labour costs) for married couples

Tax wedge for a single income married couple earning the average wage with two children (left) and for a dual income married couple earning 100 and 33 per cent of the average wage with two children (right), OECD-30



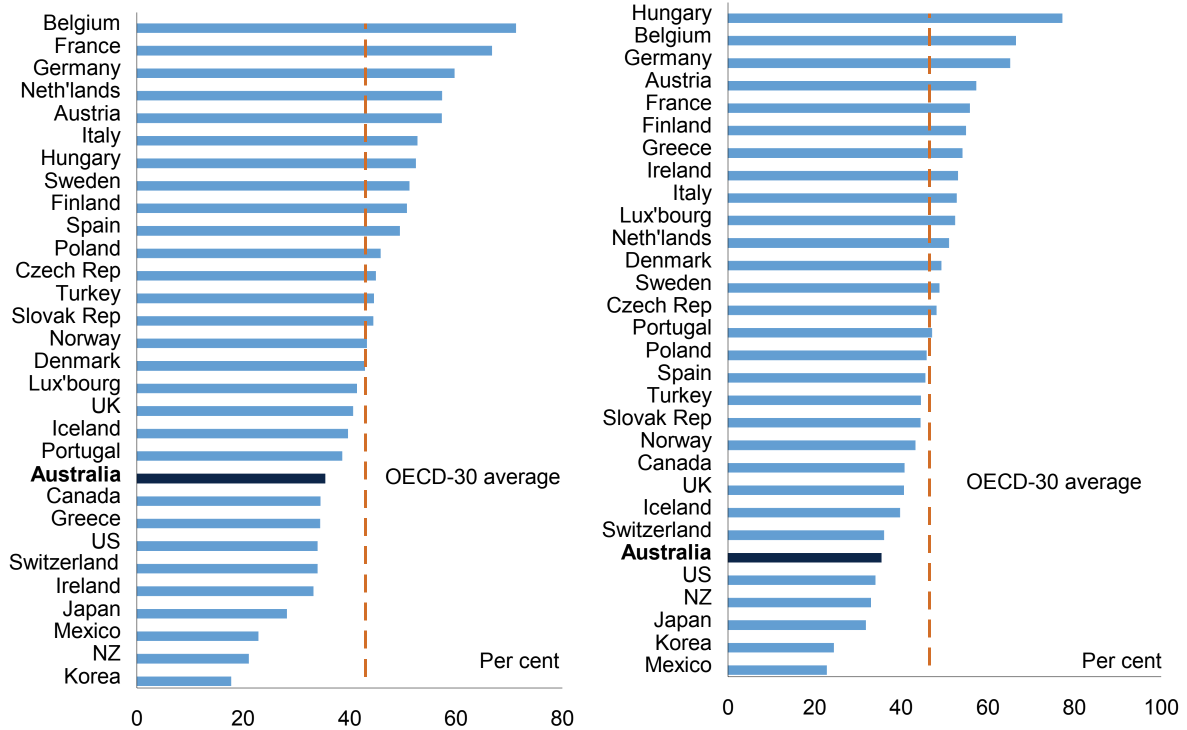
Tax wedge for a dual income married couple earning 100 and 67 per cent of the average wage with two children (left) and for a dual income married couple earning 100 and 33 per cent with no children (right), OECD-30



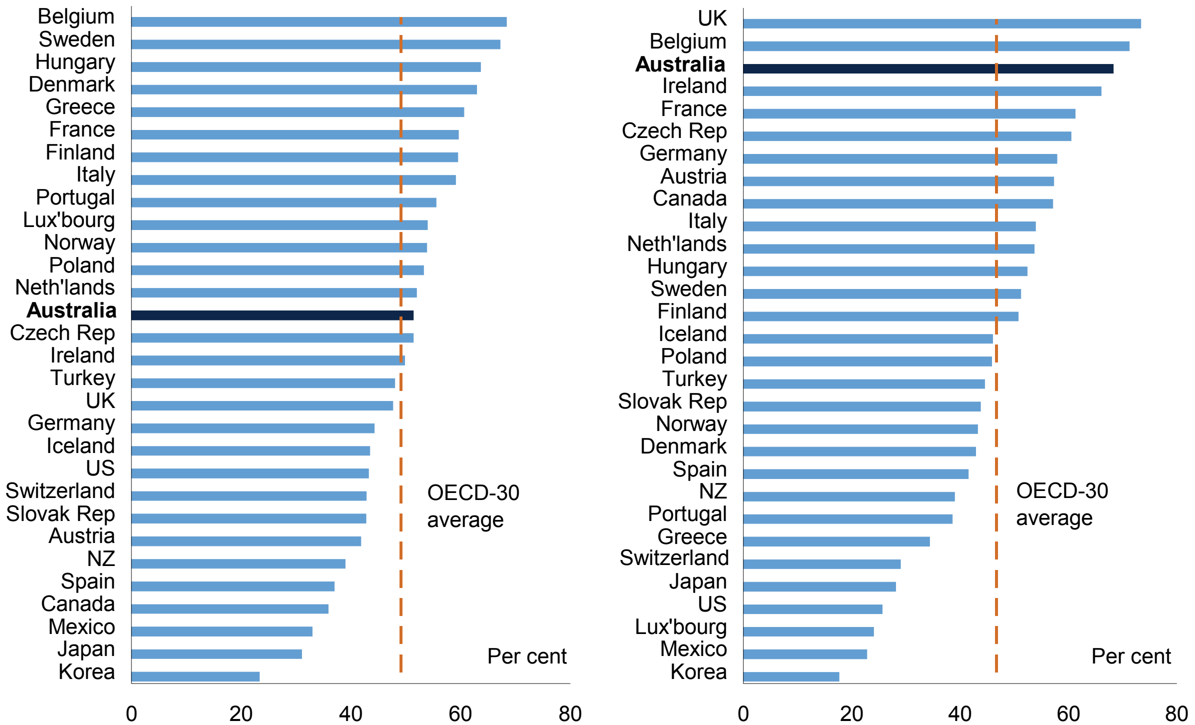
Source: OECD *Taxing Wages*, 2005.

Appendix chart 4.1.4: Marginal Tax wedge for singles

Marginal tax wedge for a single worker earning 67 per cent of the average wage with no children (left) and for an average worker with no children (right), OECD-30



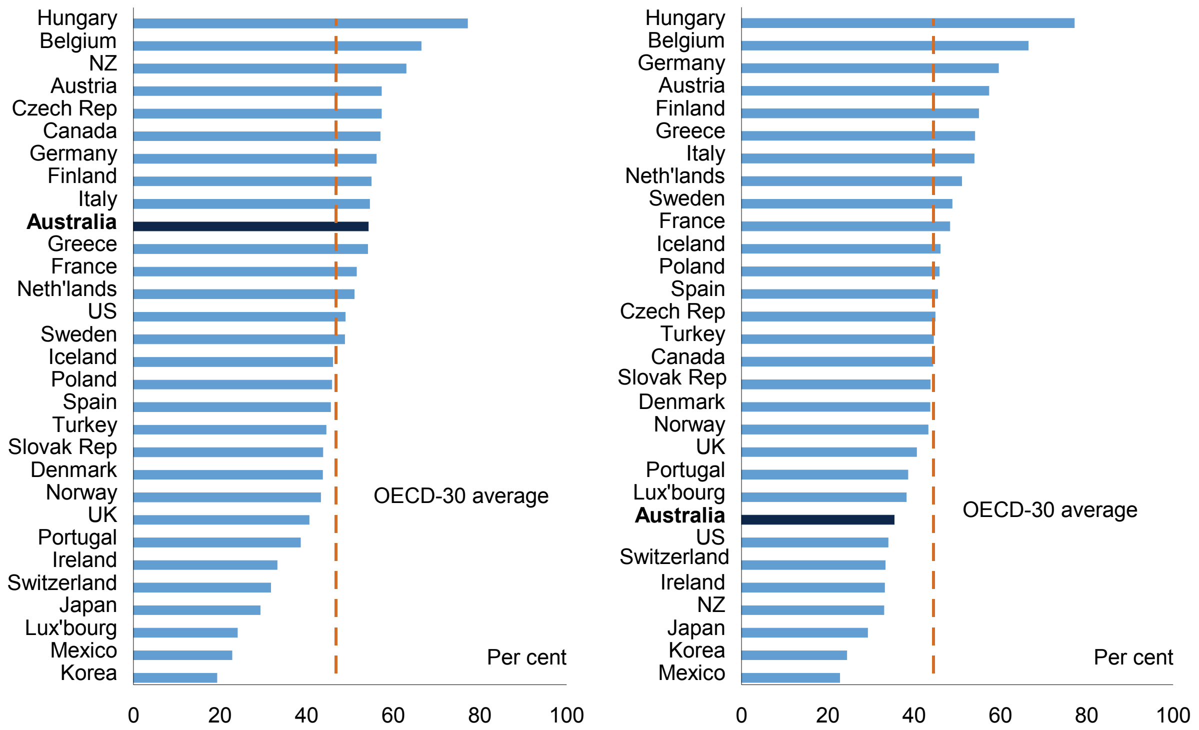
Marginal tax wedge for a single average worker earning 167 per cent of the average wage (left) and for a single parent earning 67 per cent of the average wage with two children (right), OECD-30



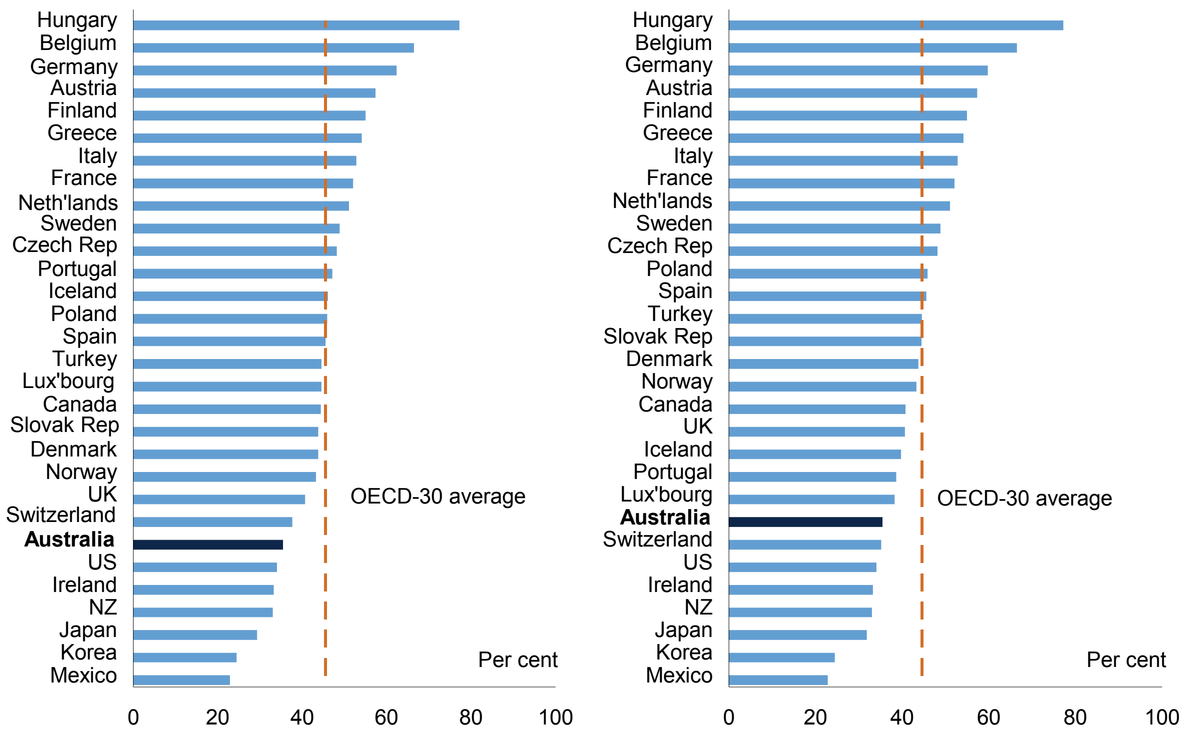
Source: OECD *Taxing Wages*, 2005.

Appendix chart 4.1.5: Marginal Tax wedge for married couples

Marginal tax wedge for a single income married couple earning the average wage with two children (left) and for a dual income married couple earning 100 and 33 per cent of the average wage with two children (right), OECD-30



Marginal tax wedge for a dual income married couple earning 100 and 67 per cent of the average wage with two children (left) and for a dual income married couple earning 100 and 33 per cent with no children (right), OECD-30

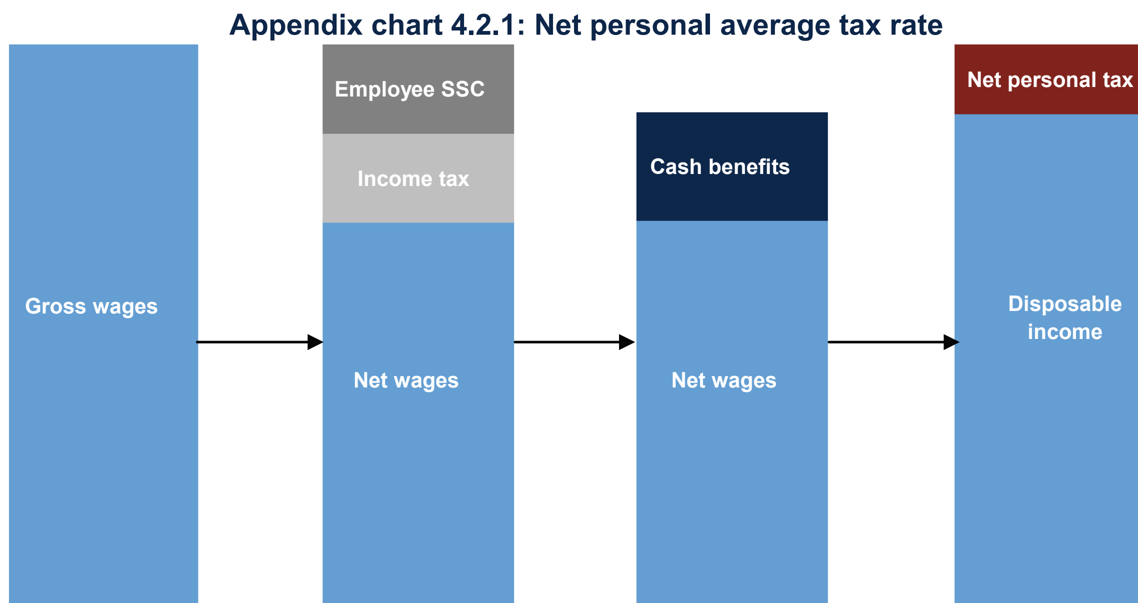


Source: OECD *Taxing Wages*, 2005.

APPENDIX 4.2: NET PERSONAL AVERAGE TAX RATE ANALYSIS

The net personal average tax rate is a measure of an employee's total wage-based tax burden. It is the sum of personal income tax plus employee social security contributions, less cash benefits as a percentage of gross wages. The net personal average tax rate is represented diagrammatically in Appendix chart 4.2.1.

Appendix chart 4.2.1: Net personal average tax rate



The net personal average tax rate can be described as a measure of a family household's wage-based disposable income, and is important since it is a measure of the employee's incentive to increase the number of hours they work or to seek promotion.

The following analysis details Australia's position amongst the OECD-30 countries for each of the eight family types using the net personal average tax rate and net personal marginal tax rate. In general, the net personal average tax rate in Australia is consistently ranked between eleventh and fifteenth lowest in the OECD-30 for seven of the eight different family types. (see Appendix table 4.2.1).

AUSTRALIA'S POSITION FOR THE EIGHT FAMILY TYPES

Appendix chart 4.2.2 and Appendix chart 4.2.3 show the net personal average tax rate of the OECD-30 for the eight family types, with Australia's position highlighted. Appendix chart 4.2.4 and Appendix chart 4.2.5 show the net personal marginal tax rate of the OECD-30 for the eight family types. The OECD averages and Australia's rankings for the net personal average tax rate and net personal marginal tax rate are summarised in Appendix table 4.2.1 to Appendix table 4.2.4.

Australia's net personal average tax rate for an average worker is 24.0 per cent, which places it thirteenth lowest in the OECD-30 and third largest in the OECD-10 after the United Kingdom and the Netherlands. The net personal marginal tax rate in Australia for an average worker with no children is 31.5 per cent, placing it ninth lowest in the OECD-30 and fifth lowest in the OECD-10.

In Australia, the net personal average tax rate for a single worker earning 67 per cent of the average wage with no children is 20.3 per cent, placing it fourteenth lowest in the OECD-30 and fourth highest in the OECD-10. The United States and the United Kingdom both have higher net personal average tax rates, while Canada and New Zealand have lower net personal average tax rates. The net personal marginal tax rate for a worker earning 67 per cent of the average wage in Australia is 31.5 per cent and is the thirteenth lowest in the OECD-30 and fourth highest in the OECD-10. This is within two percentage points of both OECD averages.

In Australia, a single worker earning 167 per cent of the average wage with no children has a net personal average tax rate of 31.7 per cent, placing it fifteenth lowest in the OECD-30 and the second largest in the OECD-10. This value is slightly below the OECD-30 average and above the OECD-10 average. The net personal marginal tax rate for this worker in Australia is 48.5 per cent of gross wages placing it eighth highest in the OECD-30 and second highest in the OECD-10.

For a single parent earning 67 per cent of the average wage with two children in Australia, the net personal average tax rate is -11.8 per cent, which is third lowest in the OECD-30 and the OECD-10. Eight other countries in the OECD-30 provide a net overall benefit to this family type and therefore have a negative net personal average tax rate. The net personal marginal tax rate in Australia for this single parent is 66.4 per cent, which is the second highest in the OECD-30 and the OECD-10 after the United Kingdom. For these single parents, the United States and Luxembourg are the only countries which have reasonably large net benefits and relatively low net personal marginal tax rates.

For a single-income married couple earning the average wage with two children, the net personal average tax rate is 10.9 per cent in Australia, placing it eleventh lowest in the OECD-30 and fourth lowest in the OECD-10. The lowest net personal average tax rate for this family type is in Ireland. The net personal marginal tax rate in Australia for this family type is 51.5 per cent, which is the fifth highest in the OECD-30 and third highest in the OECD-10.

In Australia a dual-income married couple with one partner earning 100 per cent and the other 33 per cent of the average wage with two children has a net personal average tax rate

of 15.7 per cent placing it twelfth lowest in the OECD-30 and fifth lowest in the OECD-10. Ireland has the lowest net personal average tax rate for these families.

In Australia, a dual-income married couple earning 100 per cent and 67 per cent of the average wage with two children has a net personal average tax rate of 18.5 per cent, which places Australia twelfth lowest in the OECD-30 and the fifth largest in the OECD-10.

For a dual-income married couple earning 100 per cent and 33 per cent of the average wage with no children, the Australian net personal average tax rate is 20.8 per cent of gross wages, which is thirteenth lowest in the OECD-30 and seventh lowest in the OECD-10.

In Australia, the net personal marginal tax rates for the last three family types discussed above all have a value of 31.5 per cent which places Australia either eleventh or thirteenth lowest in the OECD-30 and fifth highest in the OECD-10. The Netherlands and Canada have the highest net personal marginal tax rate in the OECD-10 for these family types.

In summary, Australia's net personal average tax rate is placed between eleventh and fifteenth lowest in the OECD-30 for seven out of the eight family types. The exception is for a single worker earning 67 per cent of the average wage with two children for which Australia is third lowest in the OECD-30. Australia's net personal marginal tax rate is above both the OECD-30 and OECD-10 averages for a single worker earning 167 per cent of the average wage with no children, a single parent earning 67 per cent of the average wage with two children and for a single income married couple earning the average wage with two children. For families with dependants, any high net personal marginal tax rates are a result of Australia's relatively highly targeted social security system.

Appendix table 4.2.1: Australia's net personal average tax rate — comparison with OECD-30

	Single no children 67%	Single no children 100%	Single no children 167%	Single 2 children 67%	Married 2 children 100%-0%	Married 2 children 100%-33%	Married 2 children 100%-67%	Married no children 100%-33%
Australia's net personal average tax rate	20.3	24.0	31.7	-11.8	10.9	15.7	18.5	20.8
OECD-30 average net personal average tax rate	22.1	26.2	32.1	5.0	14.9	17.6	20.4	22.8
Australia's rank in the OECD-30	14	13	15	3	11	12	12	13

Note: The country with the smallest net personal average tax rate has a rank of one.
Source: OECD *Taxing Wages*, 2005.

Appendix table 4.2.2: Australia's net personal average tax rate — comparison with OECD-10

	Single no children 67%	Single no children 100%	Single no children 167%	Single 2 children 67%	Married 2 children 100%-0%	Married 2 children 100%-33%	Married 2 children 100%-67%	Married no children 100%-33%
Australia's net personal average tax rate	20.3	24.0	31.7	-11.8	10.9	15.7	18.5	20.8
OECD-10 average net personal average tax rate	19.6	22.9	28.4	-2.5	12.0	15.3	18.0	19.8
Australia's rank in the OECD-10	7	8	9	3	4	5	6	7

Note: The country with the smallest net personal average tax rate has a rank of one.
Source: OECD *Taxing Wages*, 2005.

Appendix table 4.2.3: Australia's net personal marginal tax rate — comparison with OECD-30

	Single no children 67%	Single no children 100%	Single no children 167%	Single 2 children 67%	Married 2 children 100%-0%	Married 2 children 100%-33%	Married 2 children 100%-67%	Married no children 100%-33%
Australia's net personal marginal tax rate	31.5	31.5	48.5	66.4	51.5	31.5	31.5	31.5
OECD-30 average net personal marginal tax rate	32.4	37.2	42.3	36.3	37.3	34.8	36.0	35.0
Australia's rank in the OECD-30	13	9	23	29	26	13	11	13

Note: The country with the smallest net personal marginal tax rate has a rank of one.
Source: OECD *Taxing Wages*, 2005.

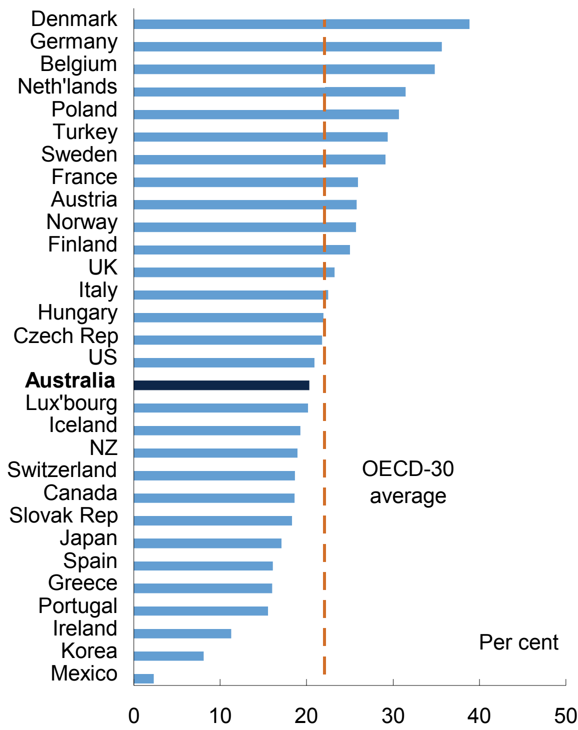
Appendix table 4.2.4: Australia's net personal marginal tax rate — comparison with OECD-10

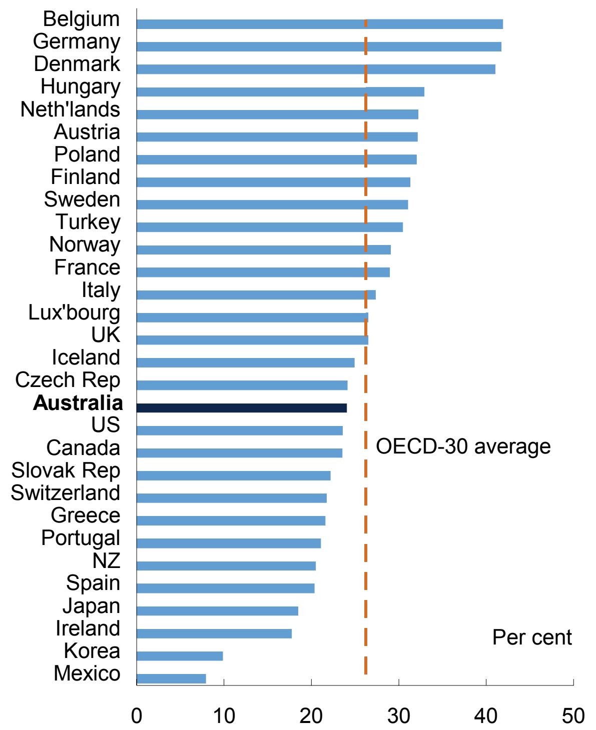
	Single no children 67%	Single no children 100%	Single no children 167%	Single 2 children 67%	Married 2 children 100%-0%	Married 2 children 100%-33%	Married 2 children 100%-67%	Married no children 100%-33%
Australia's net personal marginal tax rate	31.5	31.5	48.5	66.4	51.5	31.5	31.5	31.5
OECD-10 average net personal marginal tax rate	29.6	33.6	39.8	41.9	39.0	31.2	31.7	31.3
Australia's rank in the OECD-10	7	5	9	9	8	6	6	6

Note: The country with the smallest net personal marginal tax rate has a rank of one.
Source: OECD *Taxing Wages*, 2005.

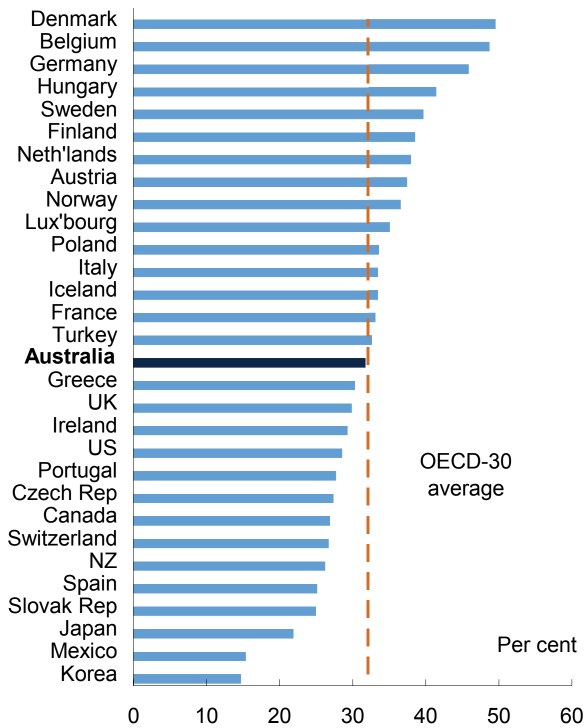
Appendix chart 4.2.2: Net personal average tax rate (as a percentage of gross wage earnings) for singles

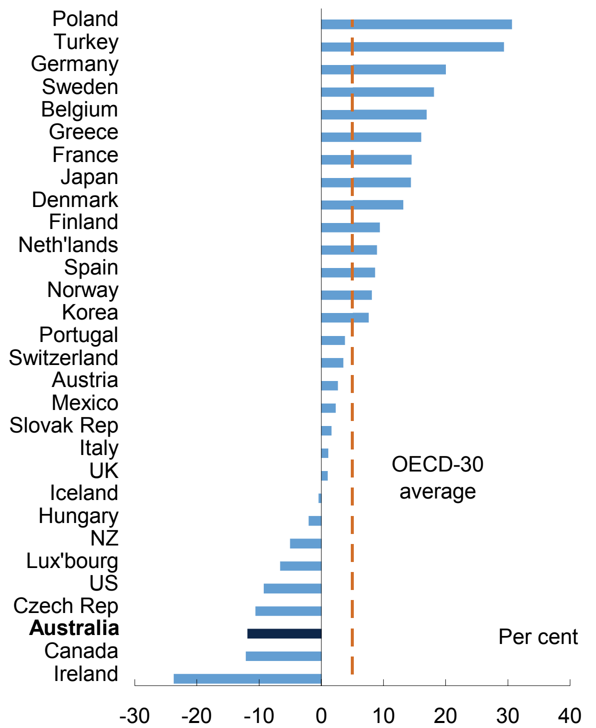
Net personal average tax rate for a single worker earning 67 percent of the average wage with no children (left) and for an average worker with no children (right), OECD-30





Net personal average tax rate for a single worker earning 167 per cent of the average wage (left) and for a single parent earning 67 per cent of the average wage with two children (right), OECD-30

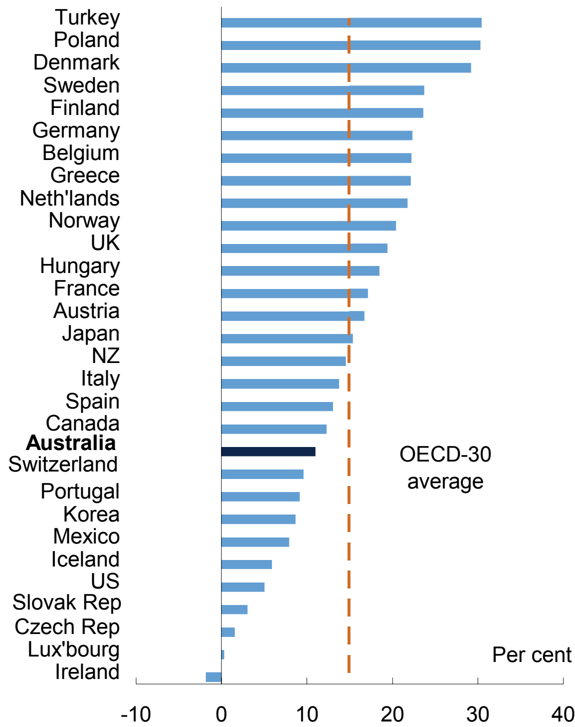


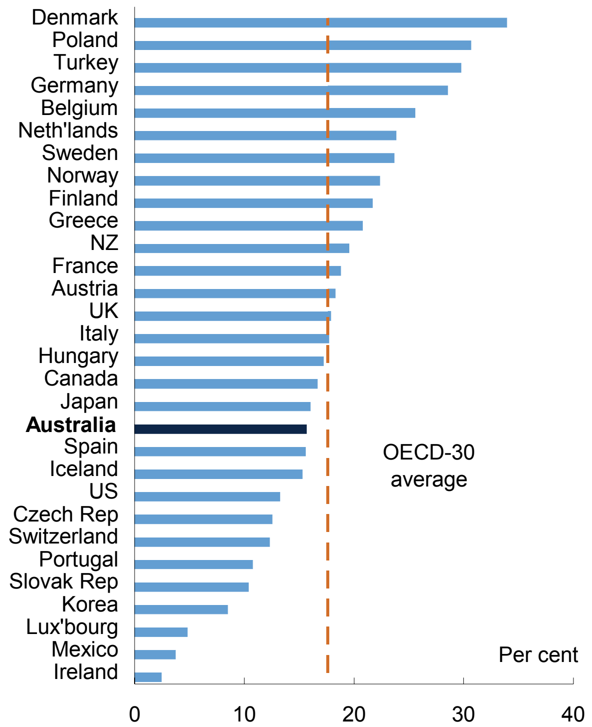


Source: OECD *Taxing Wages*, 2005.

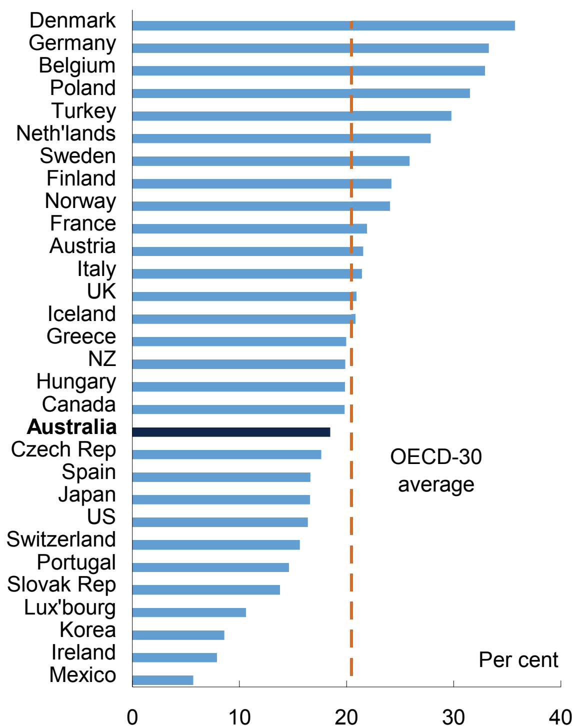
Appendix chart 4.2.3: Net personal average tax rate (as a percentage of gross wage earnings) for married couples

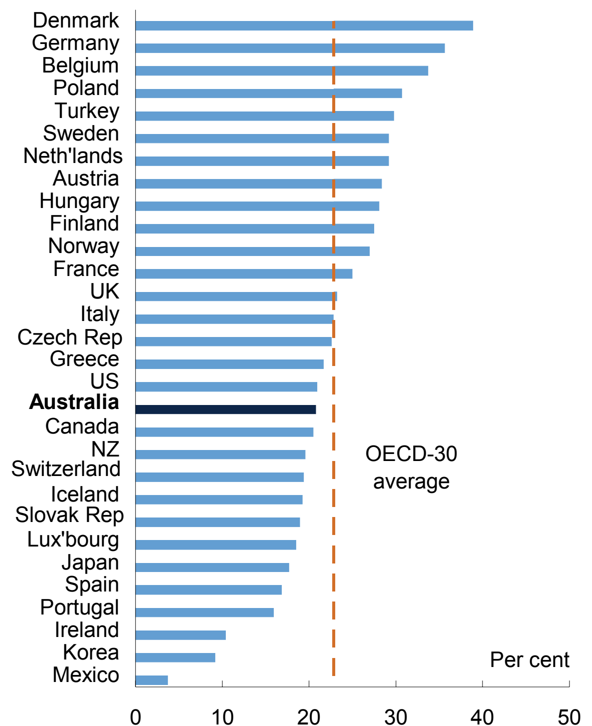
Net personal average tax rate for a single income married couple earning the average wage with two children (left) and for a dual income married couple earning 100 and 33 per cent of the average wage with two children (right), OECD-30





Net personal average tax rate for a dual income married couple earning 100 and 67 per cent of the average wage with two children (left) and for a dual income married couple earning 100 and 33 per cent with no children (right), OECD-30

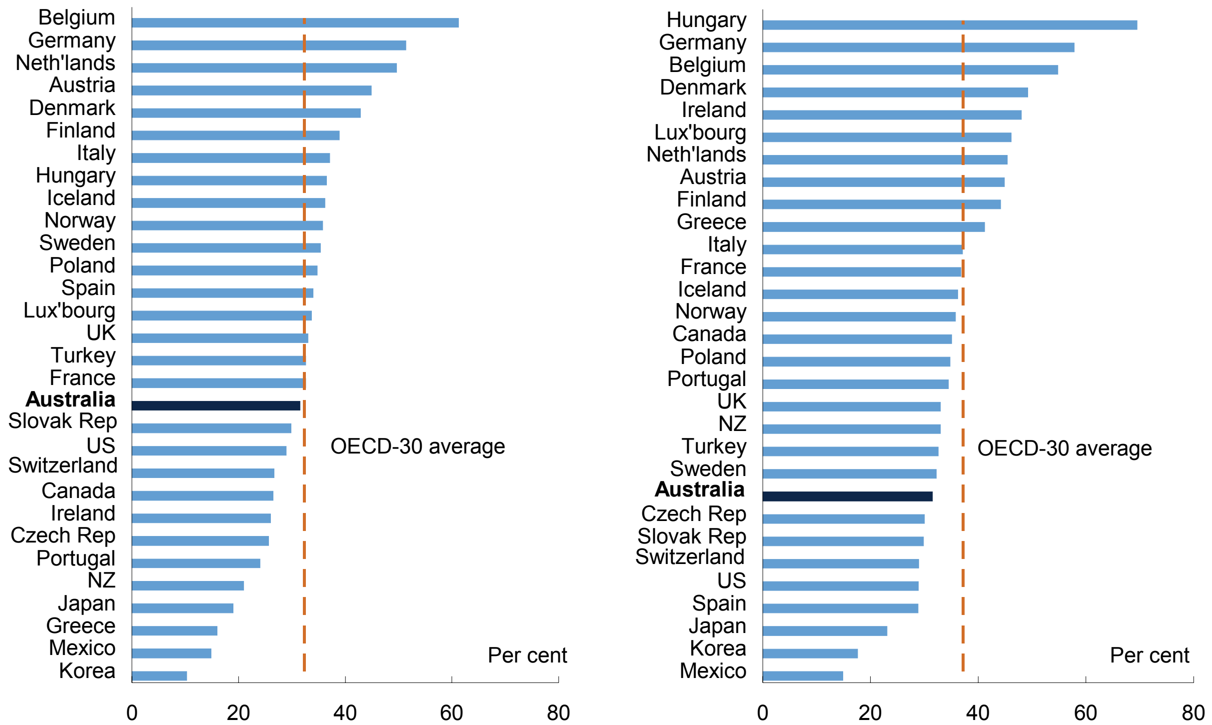




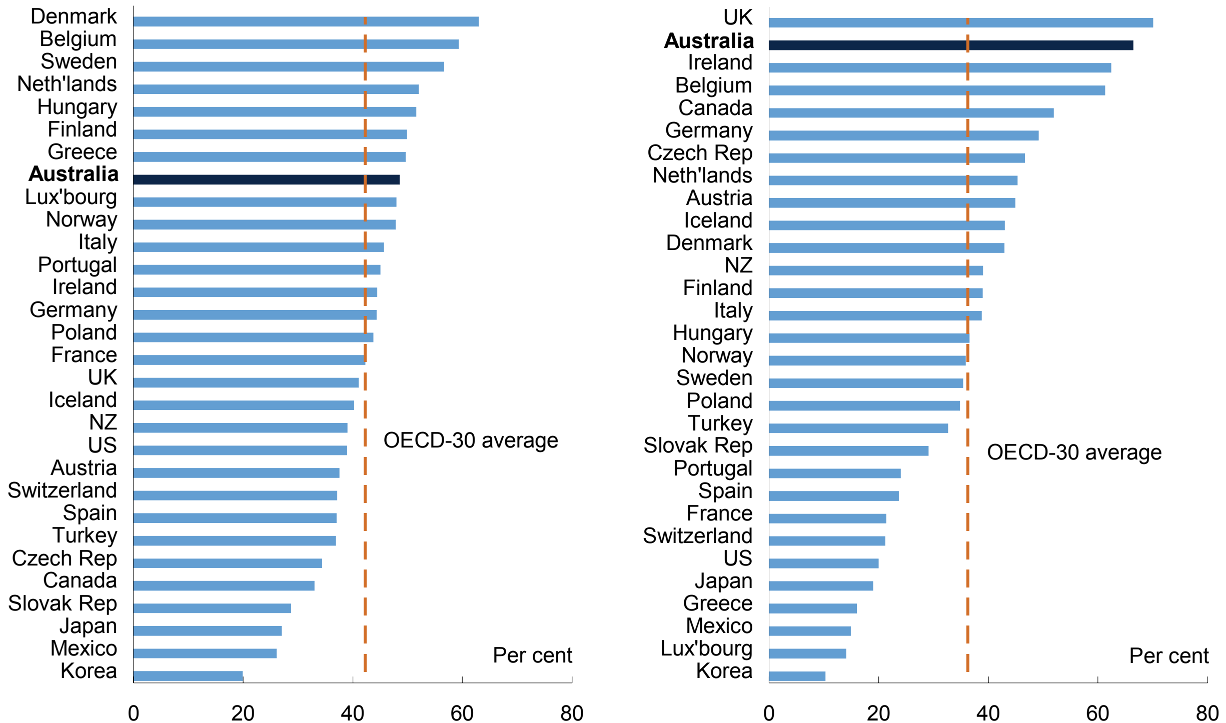
Source: OECD *Taxing Wages*, 2005.

Appendix chart 4.2.4: Net personal marginal tax rate for singles

Net personal marginal tax rate for a single worker earning 67 percent of the average wage with no children (left) and for an average worker with no children (right), OECD-30



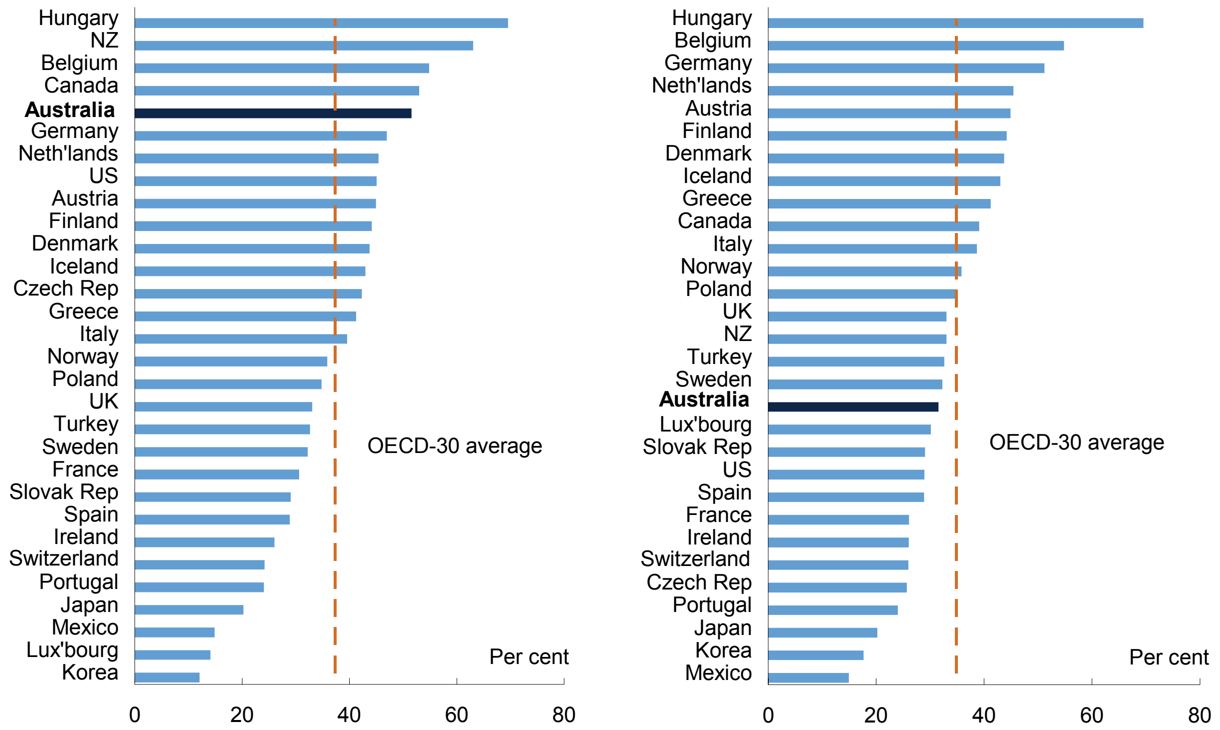
Net personal marginal tax rate for a single average worker earning 167 per cent of the average wage (left) and for a single parent earning 67 per cent of the average wage with two children (right), OECD-30



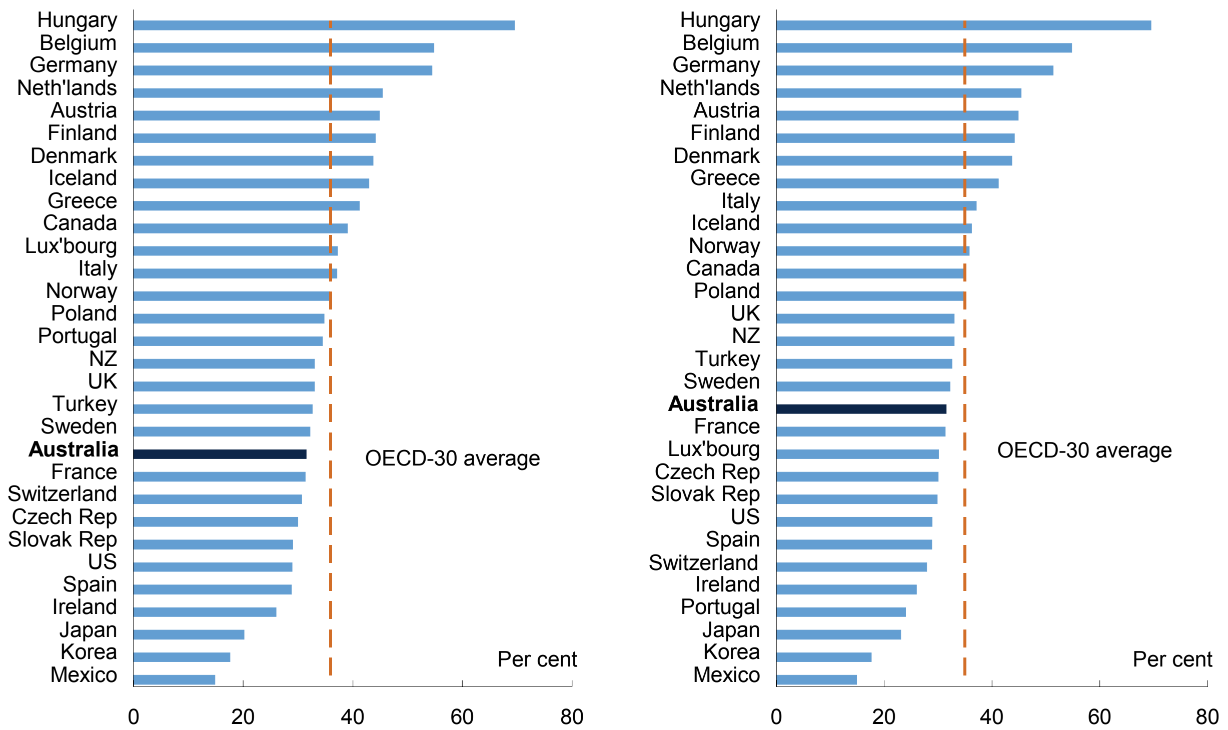
Source: OECD *Taxing Wages*, 2005.

Appendix chart 4.2.5: Net personal marginal tax rate for married couples

Net personal marginal tax rate for a single income married couple earning the average wage with two children (left) and for a dual income married couple earning 100 and 33 per cent of the average wage with two children (right), OECD-30



Net personal marginal tax rate for a dual income married couple earning 100 and 67 per cent of the average wage with two children (left) and for a dual income married couple earning 100 and 33 per cent with no children (right), OECD-30



Source: OECD *Taxing Wages*, 2005.

APPENDIX 4.3: TAX WEDGE FAMILY COMPARISONS

This appendix analyses the family type comparison of the tax wedge and the marginal tax wedge for each country in the OECD-30. Comparing different family types provides insights into the effects on tax and benefits of family composition and of additional earnings from a second earner. The family type comparisons examined in this appendix are:

(a) comparing the average worker (AW) with no children to a single-income married couple earning the average wage with two children. This demonstrates the difference between the tax treatment of singles and families;

(b) comparing a single worker earning 67 per cent of the average wage, to the same worker with two dependent children. This shows how the tax system treats the inclusion of dependants for single workers;

(c) comparing a dual-income married couple with no children, earning an average wage and 33 per cent of an average wage, to the same couple with two dependent children. This shows how the tax system treats the inclusion of dependants for married couples; and

(d) comparing a single-income married couple earning the average wage with two children, to a dual-income married couple with two children, with the second income being 33 per cent of the average wage. This shows the effect of a partner starting work or re-entering the labour force.

In general:

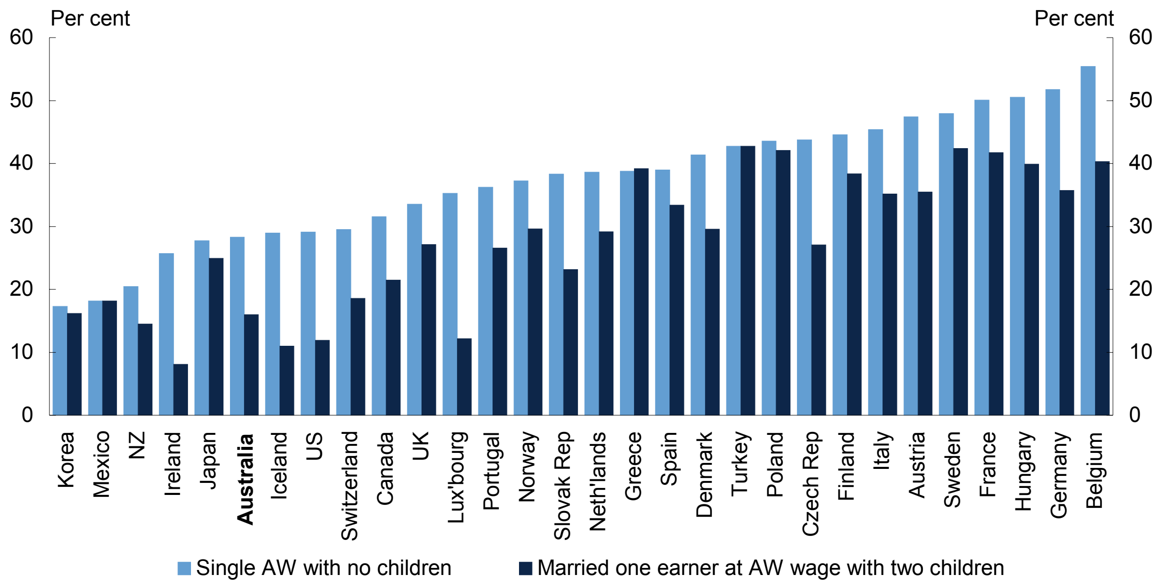
- Families receive assistance from cash benefits or the tax system in most OECD-30 countries compared to singles. Australia's tax wedge reductions are the ninth largest in the OECD-30.

- Sole parents receive significant cash benefits across the OECD-30. Australia's tax wedge reductions are the second largest in the OECD-30.

- Most OECD-30 countries offer assistance to families with dependant children, compared to families without children. Australia's tax wedge reduction is similar to the OECD-30 average.

- Approximately half the OECD-30 countries have an increased tax wedge for families with a second earner compared to a single-income family. Australia's tax wedge also increases for dual-earner families with higher incomes.

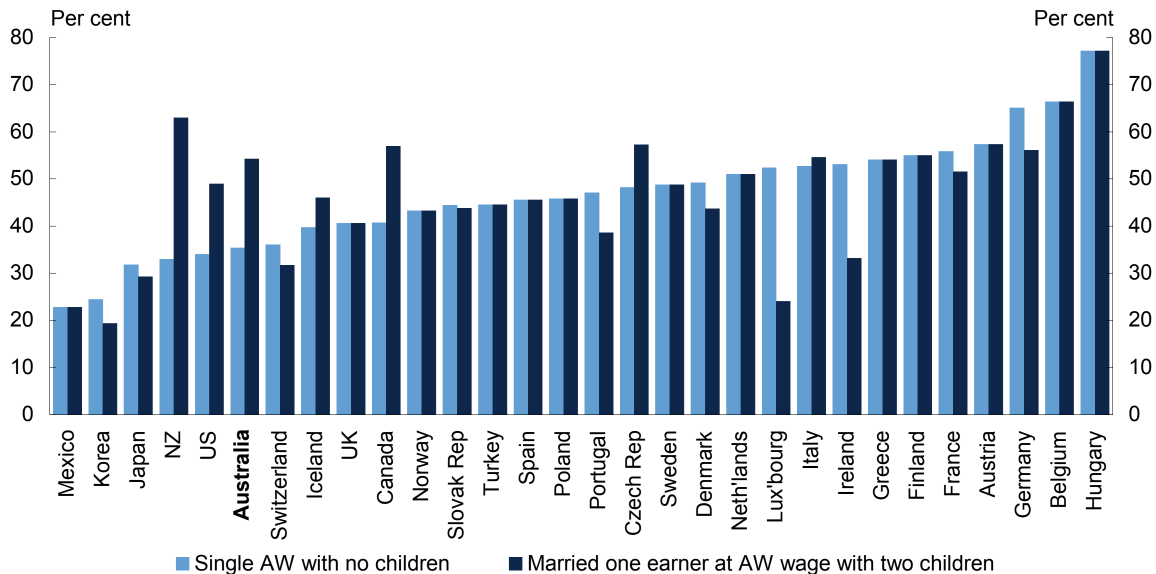
Appendix chart 4.3.1: Tax wedge comparison of a single average worker with no children to a single-income married couple earning the average wage with two children
OECD-30



Source: OECD *Taxing Wages*, 2005.

Appendix chart 4.3.1 shows the tax wedge for a single worker earning the average wage compared to a single-income married couple earning the average wage with two children. In Australia, the tax wedge for a single-income married couple earning the average wage with two children is 12.3 percentage points lower than that of the average worker. Most OECD-30 countries reduce the tax wedge of married couples with dependent children, compared to the average single worker either through cash benefits or tax relief. Australia's tax wedge reduction of 12.3 percentage points is the ninth largest in the OECD-30.

Appendix chart 4.3.2: Marginal tax wedge comparison of a single average worker with no children to a single-income married couple earning the average wage with two children
OECD-30

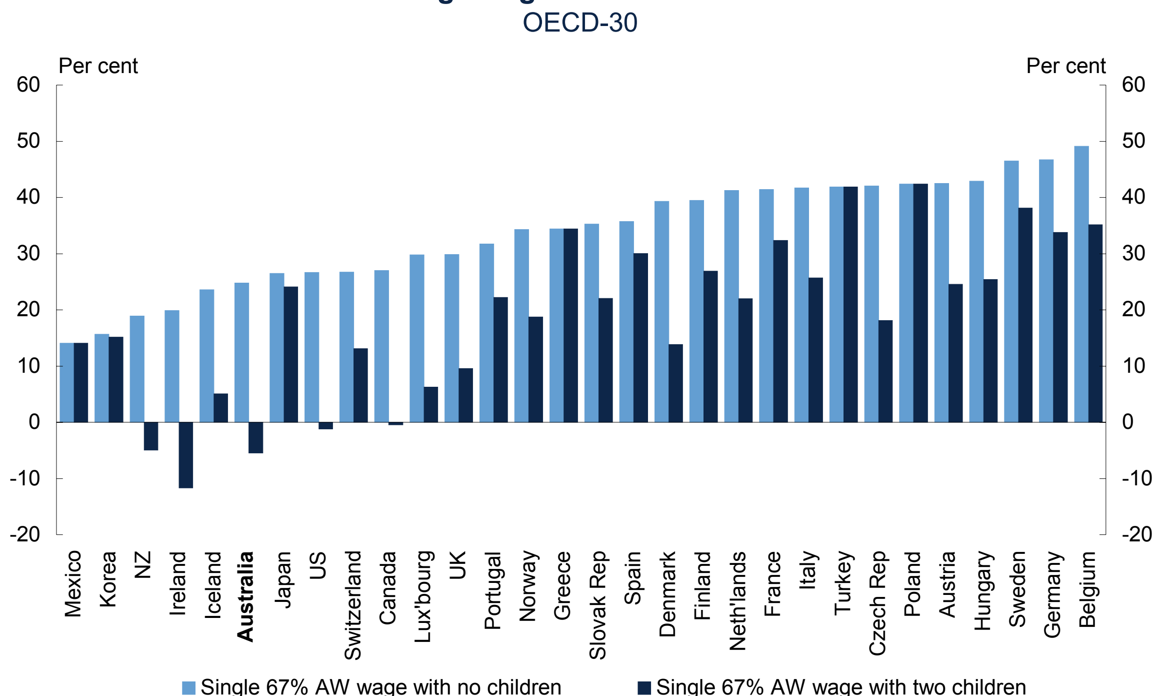


Source: OECD *Taxing Wages*, 2005.

Appendix chart 4.3.2 shows the marginal tax wedge for a single worker earning the average wage compared to a single-income married couple earning the average wage with two children. In Australia, the marginal tax wedge for this married couple is 18.9 percentage points larger than that of an average worker. This is the second highest difference in the OECD-30 after New Zealand, which has a difference of 30 percentage points. Canada and the United States have increases of 14 percentage points or more for the family with two children compared to the average worker.

Appendix chart 4.3.3: Tax wedge comparison of a single worker earning 67 per cent of the average wage with no children to a single parent earning 67 per cent of the average wage with two children

OECD-30

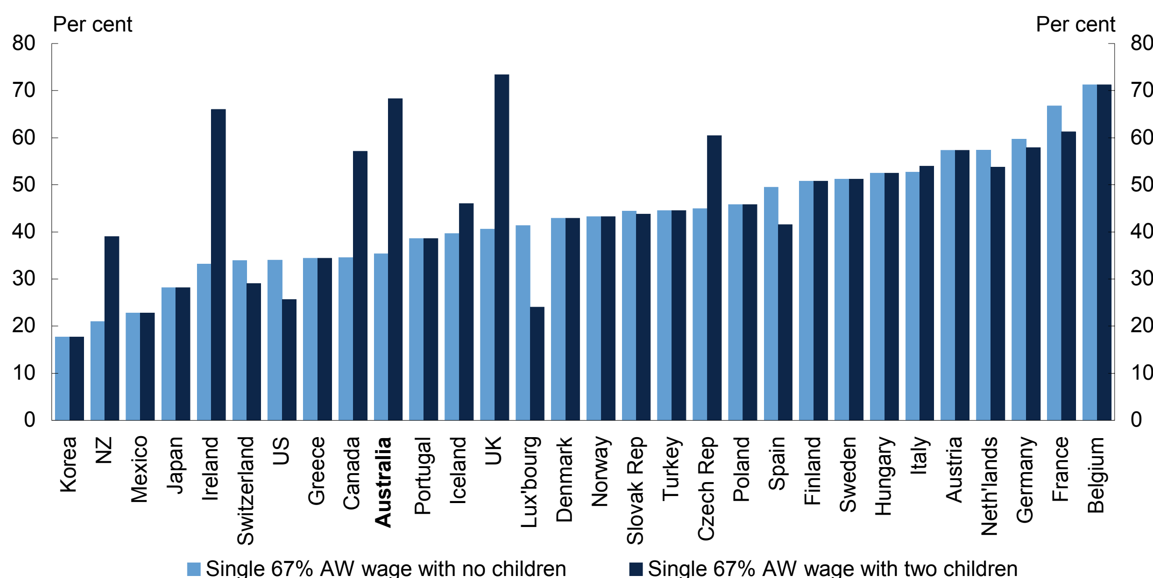


Source: OECD *Taxing Wages*, 2005.

Appendix chart 4.3.3 shows the tax wedge for a single worker earning 67 per cent of the average wage with no children, compared to a single worker earning the same amount with two children. In Australia, the tax wedge for a single parent earning 67 per cent of the average wage with two children is 30.3 percentage points lower than the corresponding single worker with no children. This is the second largest difference in the OECD-30 after Ireland. The United States and Canada also have differences larger than 25 percentage points.

Appendix chart 4.3.4: Marginal tax wedge comparison of a single worker earning 67 per cent of the average wage with no children to a single parent earning 67 per cent of the average wage with two children

OECD-30

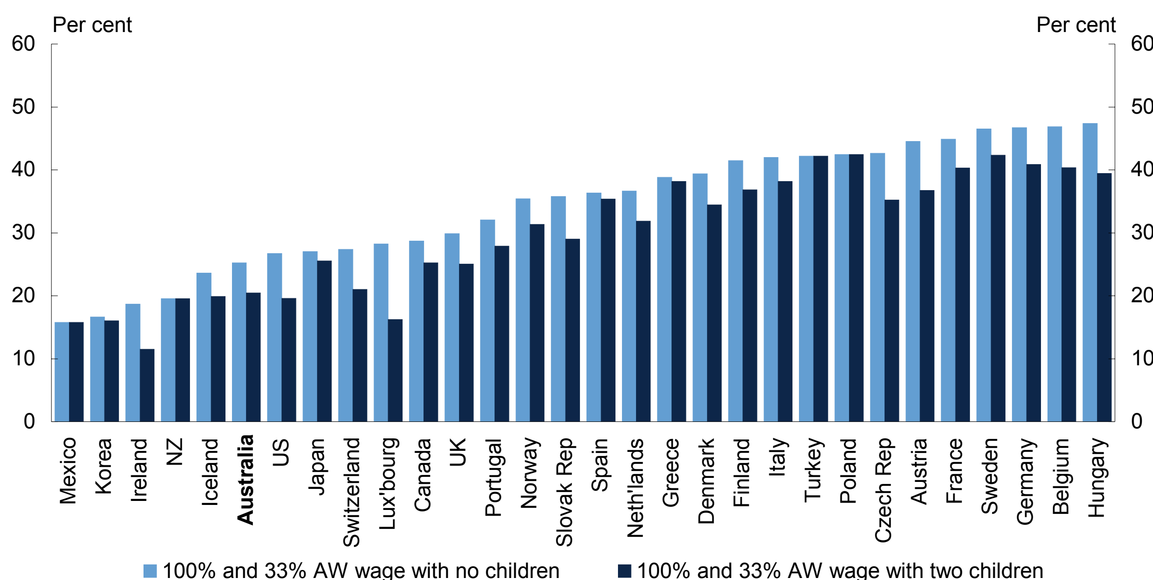


Source: OECD *Taxing Wages*, 2005.

Appendix chart 4.3.4 shows the marginal tax wedge for a single worker earning 67 per cent of the average wage with no children compared to the same worker with two children. In Australia, the marginal tax wedge for this worker with two children is 32.9 percentage points larger than that of the corresponding worker with no children. This is the largest difference in the OECD-30 followed by Ireland, the United Kingdom, Canada and New Zealand.

Appendix chart 4.3.5: Tax wedge comparison of a dual-income family earning 100 per cent and 33 per cent of the average wage with no children to the same family type with two children

OECD-30

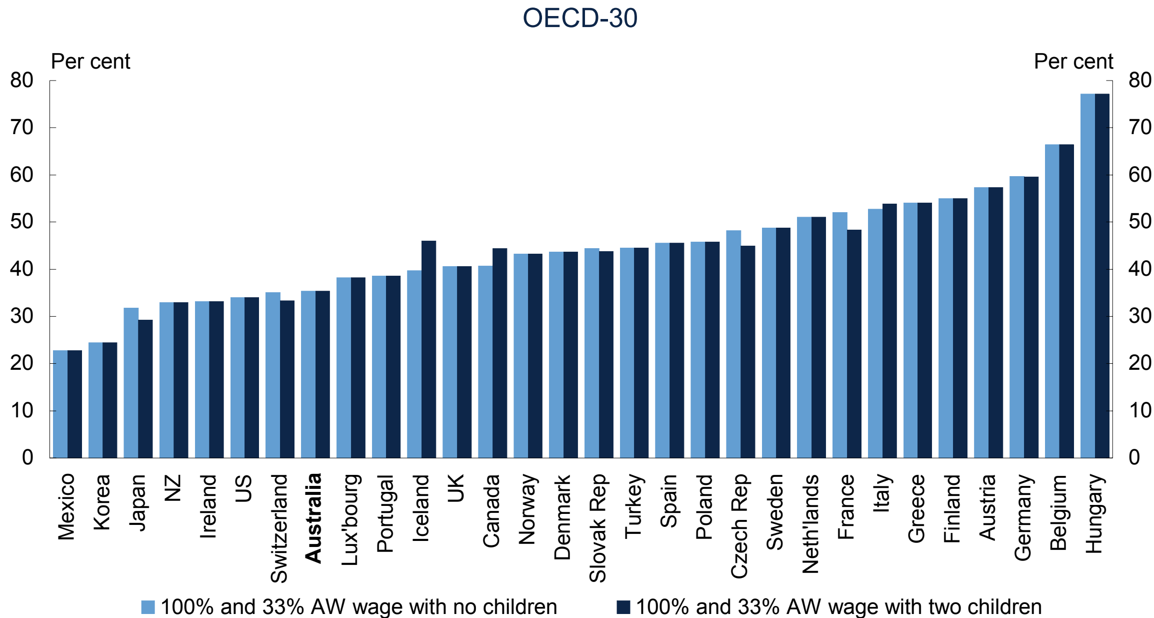


Source: OECD *Taxing Wages*, 2005.

Appendix chart 4.3.5 shows the tax wedge for a dual-income married couple earning 100 per cent and 33 per cent of the average wage with no children, compared to the same couple with two children. The tax wedge in Australia for this family with two children is 4.8 percentage points lower than the corresponding family with no children and is almost the same as the OECD-30 average, placing Australia thirteenth largest in the OECD-30.

Appendix chart 4.3.6: Marginal tax wedge comparison of a dual-income family earning 100 per cent and 33 per cent of the average wage with no children to the same family type with two children

OECD-30

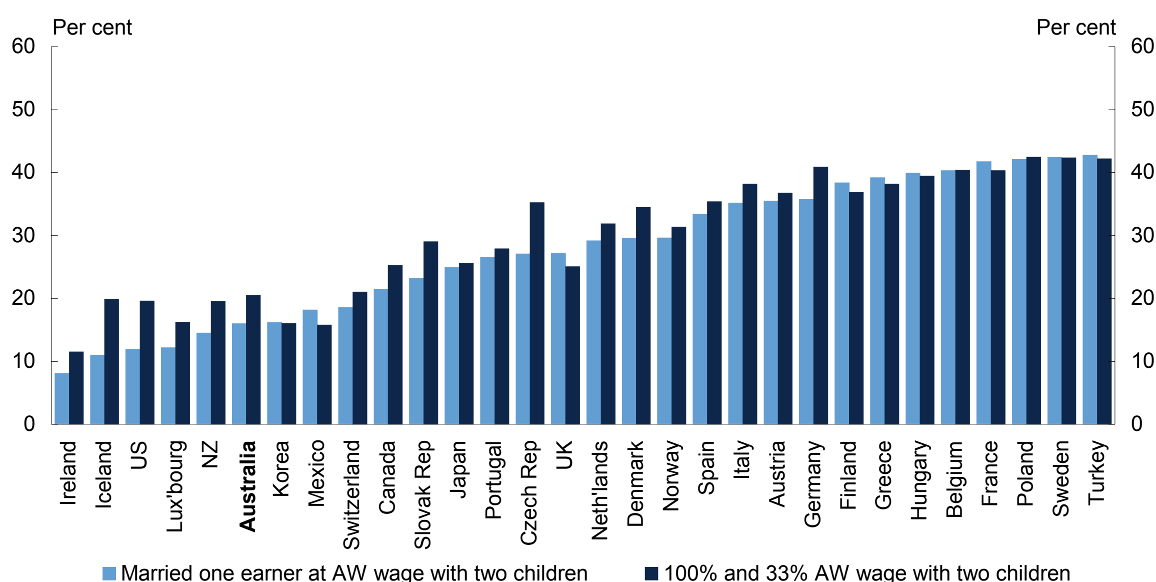


Source: OECD *Taxing Wages*, 2005.

Appendix chart 4.3.6 shows the marginal tax wedge for a dual-income married couple earning 100 per cent and 33 per cent of the average wage with no children, compared to the same couple with two children. The Australian marginal tax wedge is the same for both of these families. This is because the family tax benefit for families with two children at this income level is paid as a flat rate per child until a much higher income is reached. This is also the case for twenty other countries in the OECD-30.

Appendix chart 4.3.7: Tax wedge comparison of a single-income married couple earning the average wage with two children to a dual-income couple earning 100 per cent and 33 per cent with two children

OECD-30

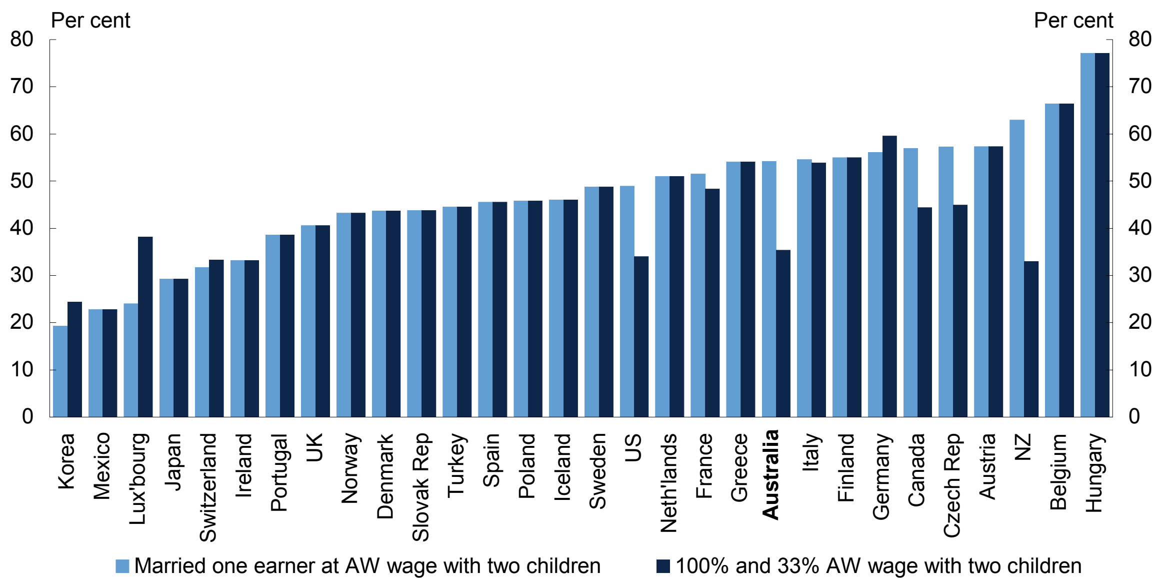


Source: OECD *Taxing Wages*, 2005.

Appendix chart 4.3.7 shows the tax wedge for a single-income married couple earning the average wage with two children compared to the same couple with a second income of 33 per cent of the average wage. In Australia, if a previously unemployed spouse returns to work and earns 33 per cent of the average wage, the overall tax wedge of the family increases by 4.5 percentage points. This is the result of family benefits being progressively phased out as the family income increases. Australia's increase in tax wedge is the eighth largest in the OECD-30. Most OECD-30 countries follow the same trend, with the tax wedge increasing at least slightly.

Appendix chart 4.3.8: Marginal tax wedge comparison of a single-income married couple earning the average wage with two children to a dual-income couple earning 100 per cent and 33 per cent with two children

OECD-30



Source: OECD *Taxing Wages*, 2005.

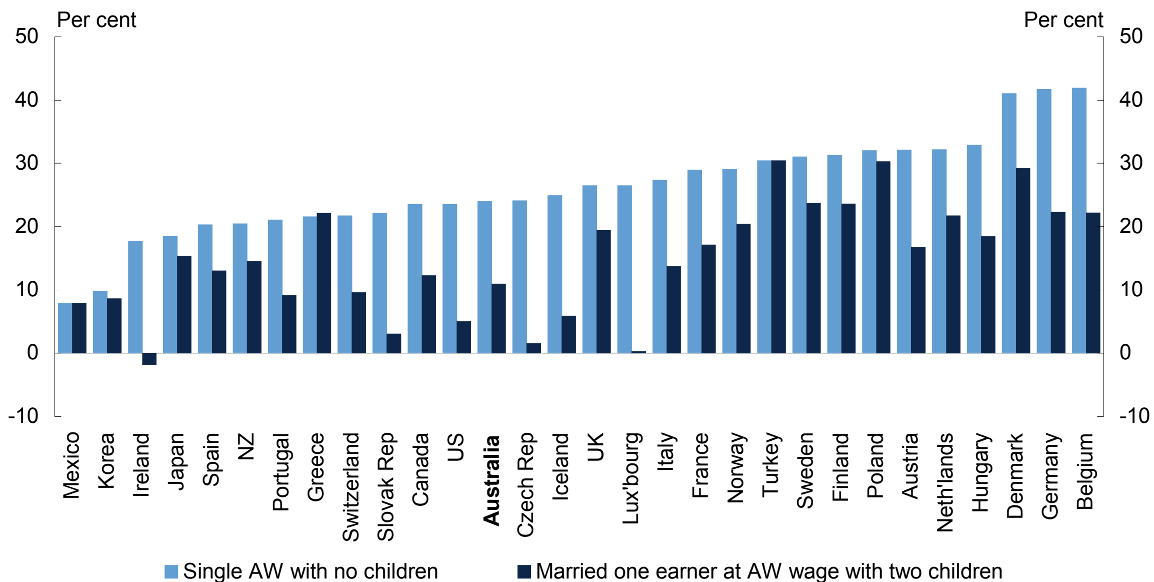
Appendix chart 4.3.8 shows the marginal tax wedge for a single-income married couple earning the average wage with two children compared to the same couple with a second income of 33 per cent of the average wage. Australia's marginal tax wedge is 18.9 percentage points lower for the dual-income family, compared to the single-income family. This is because the single-income family receives family benefits that are included in its marginal tax wedge, while the dual-income family does not. This is the second largest decrease in the OECD-30. Only New Zealand has a larger decrease of 30 percentage points, while the United States and Canada have decreases of 12 percentage points or more.

APPENDIX 4.4: NET PERSONAL AVERAGE RATE FAMILY COMPARISONS

This appendix contains a comparison of the net personal average tax rates between the pairs of family types discussed in Appendix 4.3.

Appendix chart 4.4.1: Net personal average tax rate comparison of a single average worker with no children to a single-income married couple earning the average wage with two children

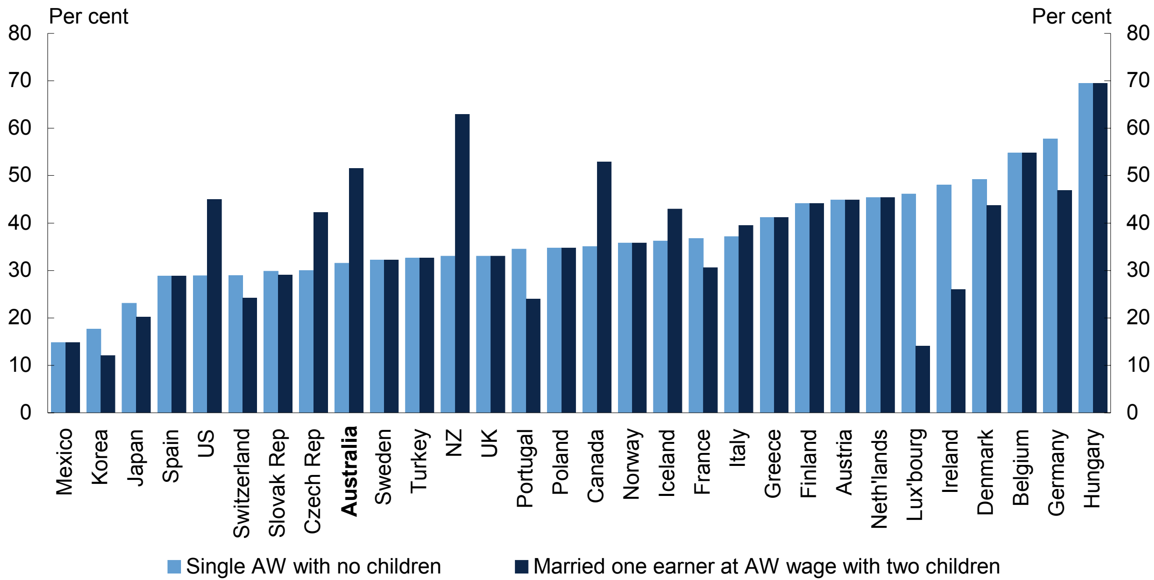
OECD-30



Source: OECD *Taxing Wages*, 2005.

Appendix chart 4.4.1 shows the net personal average tax rate for a single average worker, compared to a single-income married couple earning the average wage with two children. In Australia, the net personal average tax rate of this family with two children is 13.1 percentage points lower than that for the average worker. This is the twelfth largest difference in the OECD-30, and is just above the OECD-30 average. Of the OECD-10 Ireland and the United States have larger differences than Australia.

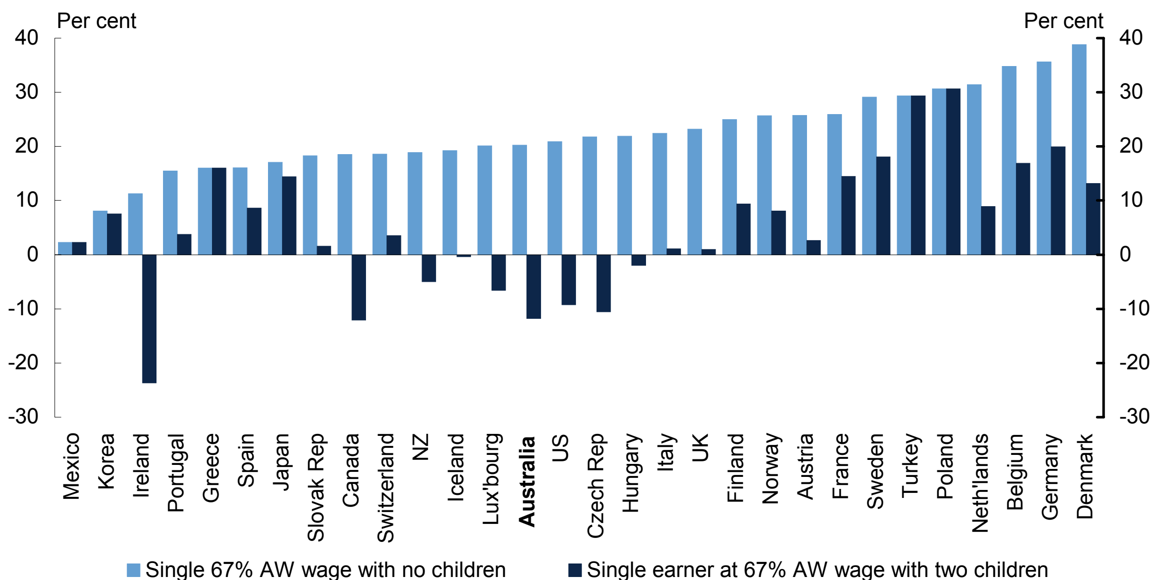
Appendix chart 4.4.2: Net personal marginal tax rate comparison of a single average worker with no children to a single-income married couple earning the average wage with two children



Source: OECD *Taxing Wages*, 2005.

Appendix chart 4.4.2 shows the net personal marginal tax rate for a single worker earning the average wage compared to a single-income married couple earning the average wage with two children. In Australia, the net personal marginal tax rate for this married couple is 20 percentage points larger than that of an average worker. This is the second largest increase in the OECD-30. Ten countries in the OECD-30 have lower net personal marginal tax rates for families than for average workers without children.

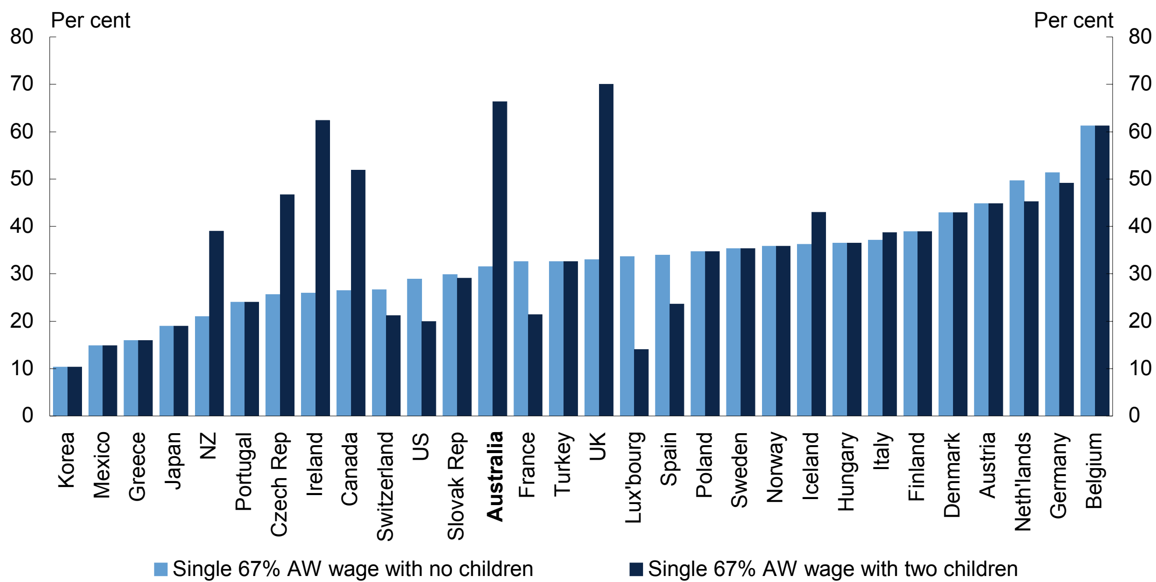
Appendix chart 4.4.3: Net personal average tax rate comparison of a single worker earning 67 per cent of the average wage with no children to a single parent earning 67 per cent of the average wage with two children



Source: OECD *Taxing Wages*, 2005.

Appendix chart 4.4.3 shows the net personal average tax rate for a single worker earning 67 per cent of the average wage with no children, compared to the same worker with two children. The net personal average tax rate provided by Australia to the single worker with two children is 32.1 percentage points lower than for the single person with no children. This decrease is the third-largest in the OECD-30. Ireland has the largest difference.

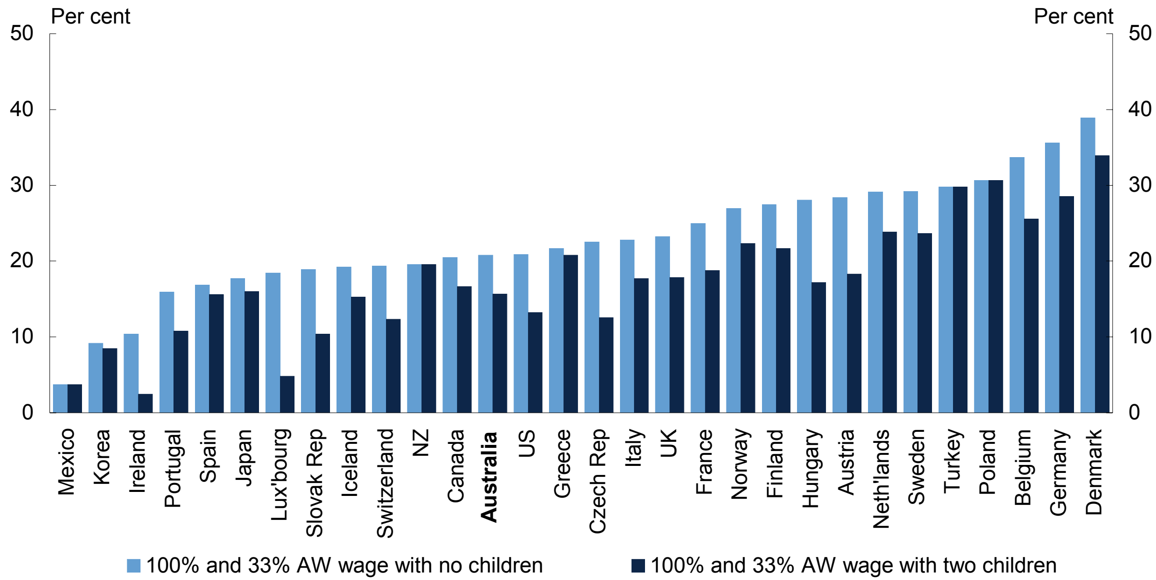
Appendix chart 4.4.4: Net personal marginal tax rate comparison of a single worker earning 67 per cent of the average wage with no children to a single parent earning 67 per cent of the average wage with two children



Source: OECD *Taxing Wages*, 2005.

Appendix chart 4.4.4 shows the net personal marginal tax rate for a single worker earning 67 per cent of the average wage with no children compared to the same worker with two children. In Australia, the net personal marginal tax rate for this single parent is 34.9 percentage points larger than the same worker with no children. This is the third largest increase in the OECD-30 after the United Kingdom and Ireland. Eight countries in the OECD-30 have a higher net personal marginal tax rate for the single parent with two children.

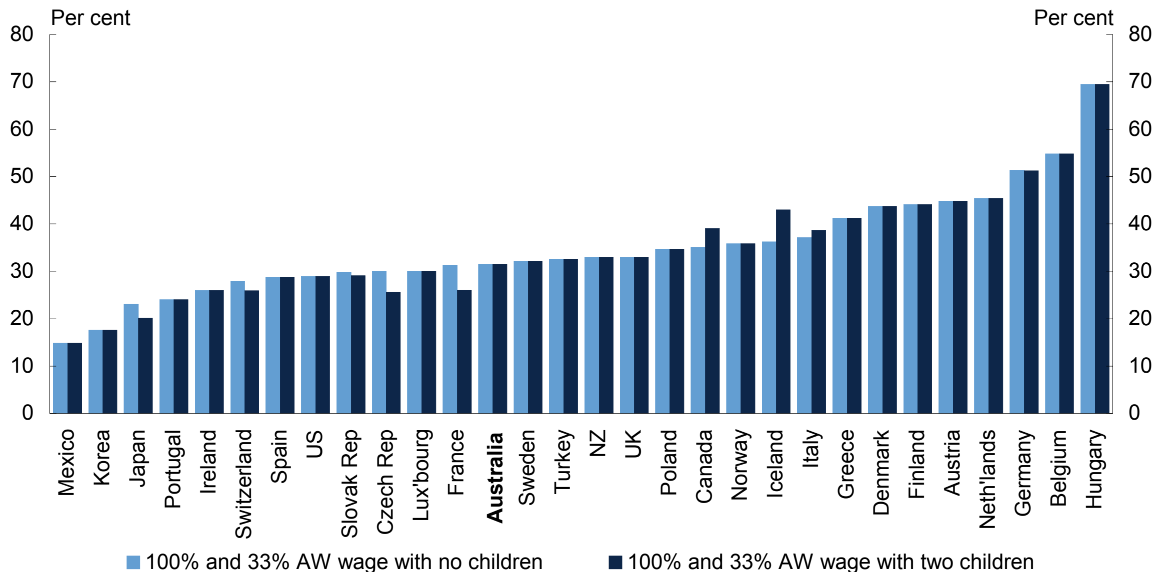
Appendix chart 4.4.5: Net personal average tax rate comparison of a dual-income family earning 100 per cent and 33 per cent of the average wage with no children to the same family type with two children



Source: OECD *Taxing Wages*, 2005.

Appendix chart 4.4.5 shows the net personal average tax rate for a dual-income married couple, earning 100 per cent and 33 per cent of the average wage with no children, compared to the same couple with two children. In Australia, the net personal average tax rate for this family with two children is 5.1 percentage points lower than for the corresponding family with no children. This is the thirteenth smallest difference in the OECD-30 and is almost the same as the OECD-30 average difference of 5.2 percentage points.

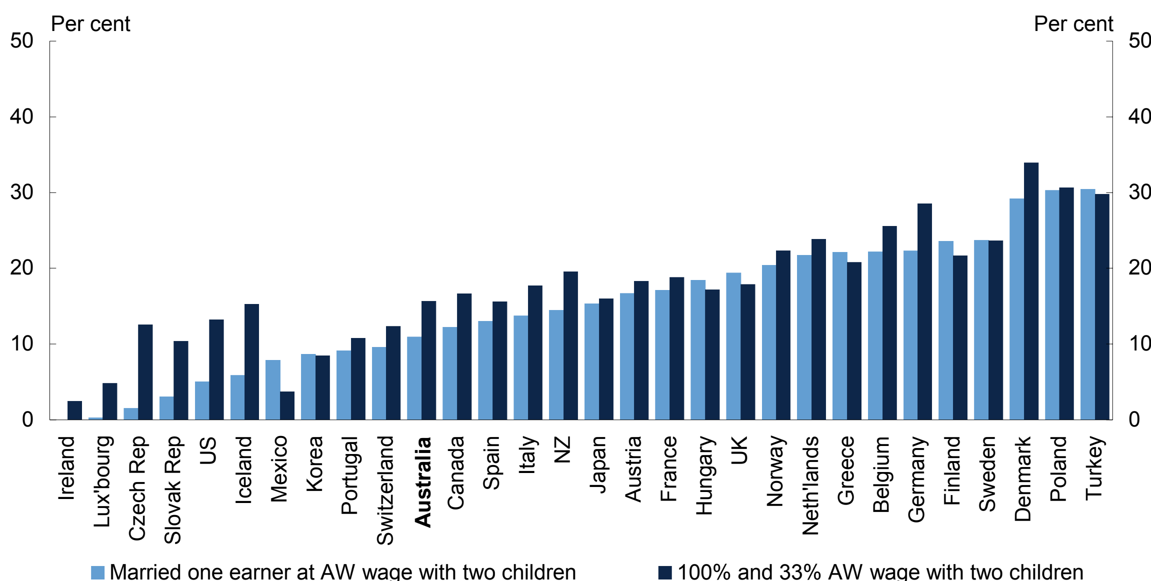
Appendix chart 4.4.6: Net personal marginal tax rate comparison of a dual-income family earning 100 per cent and 33 per cent of the average wage with no children to the same family type with two children



Source: OECD *Taxing Wages*, 2005.

Appendix chart 4.4.6 shows the net personal marginal tax rate for a dual-income married couple earning 100 per cent and 33 per cent of the average wage with no children compared to the same couple with two children. Like the marginal tax wedge, the Australian net personal marginal tax rate is the same for both these families. This is because the family tax benefit for families with two children at this income level is paid as a flat rate per child until a much higher income is reached. Twenty other countries in the OECD-30 also have the same net personal marginal tax rates for these family types. The differences for most OECD-30 countries are generally quite small.

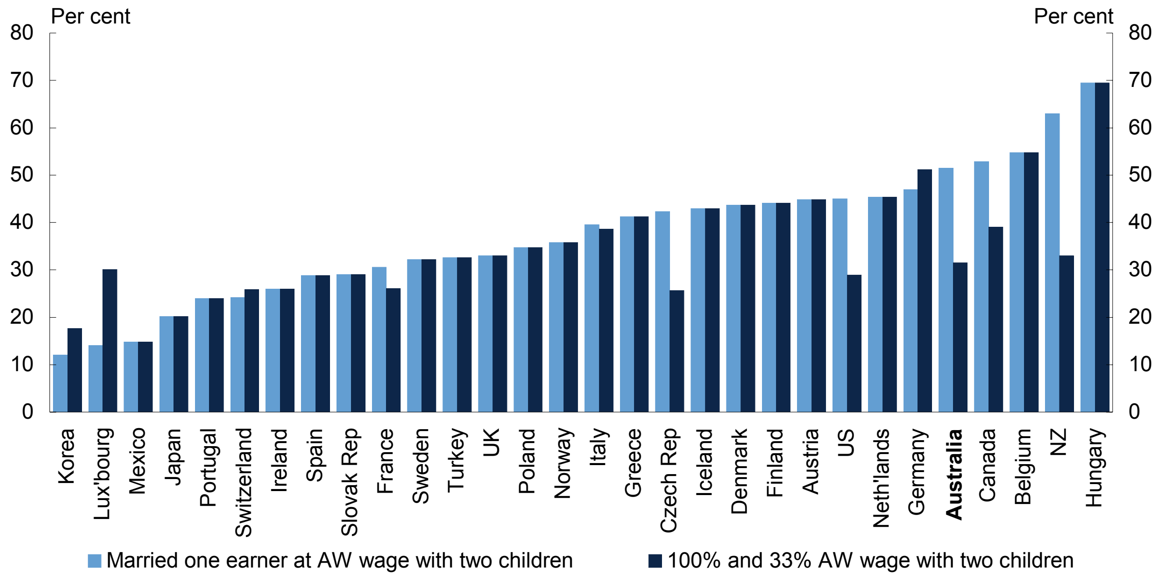
Appendix chart 4.4.7: Net personal average tax rate comparison of a single-income married couple earning the average wage with two children to a dual-income couple earning 100 per cent and 33 per cent with two children



Source: OECD *Taxing Wages*, 2005.

Appendix chart 4.4.7 shows the net personal average tax rate for a single-income married couple earning the average wage with two children, compared to a dual-income married couple earning 100 per cent and 33 per cent of the average wage with two children. The net personal average tax rate in Australia for this dual-income family is 4.7 percentage points higher than for the single-income family. This difference is the seventh-largest increase in the OECD-30.

Appendix chart 4.4.8: Net personal marginal tax rate comparison of a single-income married couple earning the average wage with two children to a dual-income couple earning 100 per cent and 33 per cent with two children



Source: OECD *Taxing Wages*, 2005.

Appendix chart 4.4.8 shows the net personal marginal tax rate for a single-income married couple earning the average wage with two children, compared to a dual-income married couple earning 100 per cent and 33 per cent of the average wage with two children. In Australia, the net personal marginal tax rate is 20.0 percentage points smaller for the dual-income family than the single-income family. This is the second largest difference in the OECD-30 after New Zealand.

Appendix 4.5: OECD-10-descriptive wage and salary taxation tables

Appendix table 4.5.1: OECD-10 assessable and exempt income

Country	Assessable income	Exempt income
Australia	Salary and wage income, allowances, dividends, interest, capital gains, business income, pensions, rents, royalties, partnership income, distributions from trusts, employee share/option interest. Fringe benefits are also taxed, although under a different rate structure to personal income tax.	Number of types of exempt income, including disability support pensions, veterans affairs disability pensions, certain pay and allowances for defence force personnel, amounts on which family trust distribution tax has been paid, family payments such as family tax benefit and child care benefit.
Canada	Income tax sources (worldwide income) — employment income, business income, property income and capital gains. Property income consists of passive income, such as rent, interest, royalties and dividends, earned through investment activities. Fringe benefits are part of the tax base.	Several types of exempt income, including capital gains realised on the disposition of a principal residence, damages for personal injury, death benefits received under a life insurance policy.
Ireland	Income is taxed according to a schedular system, based on the nature of the income source. The current applicable schedules are: C: profits from payment of interest and dividends out of public revenue when payable in Ireland; D Case I: trading profits, Case II: profits from the exercise of professions, Case III: untaxed interest and foreign income, Case IV: any other income or profit not otherwise taxable, Case V: rental income from land in Ireland; E: income from employment and pensions; F: distributions from resident corporations.	Specific exemptions are granted for several items, for example, royalties received by resident taxpayers from patents (provided that the activity leading to its invention was carried out in Ireland).
Japan	Total worldwide income of resident individuals is subject to income tax. There are 10 income sources that income taxes apply to: interest, dividend, real estate, business, employment, retirement, forestry, capital gains, occasional and miscellaneous income. Some benefits in kind received by the taxpayers are assessable to the taxpayer, for example, private use of an employer provided automobile.	Several forms of exempt employment income, such as some benefits in kind (for example moving expenses), commuter allowance up to a maximum threshold. Exemption for interest accrued from current bank deposits.
Netherlands	A schedular system operates. Only the items included in the schedule are taxable. The schedule contains different boxes. Box 1 includes income from employment, business, other activities, periodical payments (from individuals and the state), owner-occupied dwellings. Fringe benefits are included in the definition of the taxable wage. Box 2 is income from substantial shareholdings (dividends and capital gains) both resident and non-resident companies. Box 3 is income from savings and investment.	Exempt income Box 3 — a number of assets are excluded from the taxable base, including owner-occupied dwellings and certain capital insurance policies used to finance owner-occupied dwellings.

Appendix table 4.5.1: OECD-10 assessable and exempt income (continued)

Country	Assessable income	Exempt income
New Zealand	Residents are subject to income tax on their worldwide income. An individual who is an employee is subject to tax on all monetary remuneration paid by an employer. Monetary remuneration means any salary, wage, allowance, bonus, gratuity, extra salary, compensation for loss of employment, emolument of whatever kind, or other benefit in money, in respect of or in relation to the employment or service of the taxpayer. Generally, fringe benefits are not included in assessable income but are instead subject to fringe benefits tax at a different rate.	Range of exempt income — including reimbursing allowances, worker's compensation under the *Worker's Compensation Act 1956,* whether received as a lump sum or weekly payments.
Spain	Income tax is levied on all worldwide income. Taxpayer income is classified into five categories: employment income, investment income, business income, capital gains and imputed income. Income is taxable in the year of accrual of the income, regardless of the time of cash receipt. If the income has been generated during more than two years, only 60 per cent of it is taxable.	Several exempt forms of income, such as pensions paid by social security to severely disabled taxpayers.
Switzerland	Taxable on worldwide income including: earned income, employment income, investment income, social security payments and income from other sources. Benefits in kind are included in employment income at their market value. These include: company cars and child care or education expenses of children paid by the employer.	Several types of exempt income, including interest on savings accounts (up to certain limits), inheritances, gifts and matrimonial property rights.
United Kingdom	Total income comprises income from all sources. Income received by an individual as salary and wages is subject to income tax as emoluments received from an office of employment. Income also includes pension income, dividends, interest, royalties, rental income and capital gains.	A number of specific exempt income categories, including interest on income tax repayments.
United States	United States citizens and residents are taxed on all income from all sources. This includes wages, salary, business income, and investment income. All income (other than capital gains and certain dividends) is combined and taxed at the same rate.	There are a number of categories of exempt income, including gifts and inheritances, and interest on bonds issued by US states and municipalities for qualified public purposes.

Source: various, see Chapter 1 (1.4.1).

Appendix table 4.5.2: OECD-10 deductions

Country	Personal allowances	Work-related deductions	Taxes/social security	Other deductions
Australia		Work-related deductions are directly related to gaining or producing an employee's assessable income.		Other deductions include gifts, film industry incentives and expenses such as the cost of managing tax affairs.
Canada		Employees only deduct expenses specifically legislated (fairly limited). Examples of specific deductions which are all subject to certain conditions — accounting and legal fees, allowable motor vehicle expenses, travelling expenses, parking, supplies, substitute's salary, office rent and work-in-the-home expenses.	A taxpayer may deduct certain amounts contributed to an RPP (a registered pension plan)	
Ireland	Total exemption applies from income tax for incomes up to €5,210 (double for married taxpayers).	Expenses incurred wholly, exclusively and necessarily in the performance of the duties of the office or employment are deductible. In general, deductions are allowed for expenditure on special clothing worn in the performance of the taxpayer's duties, expenditure on tools and extra expenditure incurred by commercial travellers.		
Japan	Types of allowances available: basic, spouse, dependants. Basic: taxpayer may deduct ¥380,000 from income. Spouse: ¥380,000 (must meet requirements). Dependant: ¥380,000 per dependant (same requirements as for the spouse).	Specific deductions that exceed the standard deduction for employment income are allowed. Specific deductions include travelling expenses.		Deductions for employment income, social insurance premiums and medical expenses.
Netherlands	Box 3 — a basic allowance of €19,522 (double for married couples).	In general, in computing taxable income from Boxes 1 and 2, all expenses incurred which are necessary to obtain, collect or maintain income may be deducted. In the case of Box 3, expenses are treated as liabilities deductible from the taxable base. Certain expenses of a mixed character are not deductible, or are deductible subject to certain limits.		

Appendix table 4.5.2: OECD-10 deductions (continued)

Country	Personal allowances	Work related deductions	Taxes/social security	Other deductions
New Zealand		Expenses incurred in producing gross income may be claimed as a deduction from income limits expenditure that is of a capital, private, exempt income and non-residents' foreign-sourced income nature, and also limits employment expenses due to withholding taxes.		
Spain	Personal allowance of €3,400 for each taxpayer, double for spouses filing a joint tax return. Family allowance depends on the number of dependants, their age and income.		Social security contributions.	Trade union fees, compulsory fees paid to professional associations and legal expenses in connection with the termination of employment.
Switzerland	Taxpayer may deduct CHF6,100 in 2006 for: • each child under 18 years of age who is supported by the taxpayer; • each child older than 18 years who is studying or learning a trade and who is supported by the taxpayer; and • each other person incapable of gaining employment. For a married couple, an annual deduction of CHF7,600 from 2006 is granted from the earned income of the spouse with the lower income.	Necessary work-related expenses are deductible.	Obligatory social security premiums are fully deductible.	Premiums for health insurance, private accident and life insurances (as well as interest received from savings accounts) are deductible up to CHF1,700 in 2006 per year for a single taxpayer and CHF3,300 in 2006 for a married couple, plus 700 for each minor child or dependent person in need. If no premiums are paid, single taxpayers may deduct CHF2,550 in 2006 and married taxpayers CHF4,950 in 2006. Interest paid on debts (limited to a maximum of CHF50,000 plus investment income), alimony and child support payments, expenses for sickness (if exceeding 5 per cent of the net income) and donations (limited).

Appendix table 4.5.2: OECD-10 deductions (continued)

Country	Personal allowances	Work related deductions	Taxes/social security	Other deductions
United Kingdom	United Kingdom personal allowance available to all taxpayers — £4,895 for 2005/2006.	Most deductions in the United Kingdom must be incurred wholly, exclusively and necessarily in the performance of an employee's duties, a condition that precludes the deduction of many employment-related expenses.		
United States	Federal personal exemption of US$3,300 in 2006. Exemption is indexed each year with inflation.	Expenses directly related to employment income may be deducted.	State and local taxes are deductible where a taxpayer chooses to itemise deductions.	Taxpayers can take a standard deduction (the amount depends on the taxpayer's filing status) or itemise their deductions.

Source: various, see Chapter 1 (1.4.1).

Appendix table 4.5.3: OECD-10 countries — tax unit

Country	Tax Unit
Australia	Individual
Canada	Individual is the tax unit, but joint taxation is also possible.
Ireland	Generally based on marital status and number of dependents, however married taxpayers can choose separate treatment.
Japan	Individual
Netherlands	Individual
New Zealand	Individual
Spain	Government regulates whether a person is taxed individually or jointly.
Switzerland	Married couples generally have to lodge tax returns together and the income is then aggregated.
United Kingdom	Individual
United States	Tax rates vary depending on the return status of the taxpayer. There are four categories: • married persons filing joint returns that combine all their income and deductions; • heads of households; • unmarried individuals, that is single taxpayers; and • married persons filing separate returns, with each spouse reporting their own income and deductions on a separate return.

Source: various, see Chapter 1 (1.4.1).

Appendix table 4.5.4: OECD-10 — National personal income tax rates and credits

Country	Tax rates	Credits
Australia	Tax rate brackets from 1 July 2006: Up to A$6,000 0 per cent A$6,000 A$21,600 15 per cent A$21,600 A$70,000 30 per cent A$70,000 A$125,000 42 per cent Over A$125,000 47 per cent Medicare levy of 1.5 per cent. Lower rates apply for low income individuals and families. Medicare levy surcharge is applied to individuals who do not have private health insurance and whose income exceeds the relevant threshold (A$50,000 for singles, A$100,000 for couples). Fringe benefits are taxed at 48.5 per cent and the tax is paid by employers.	Low income tax offset — maximum of $235. Payable up to incomes of A$21,600, phasing out at 4 cents in the dollar up to A$27,475. Range of other offsets including offsets for dependants, seniors, pensioners and medical expenses. Three refundable tax offsets — baby bonus, private health insurance and franking tax offset.
Canada	Tax rate brackets from 1 January 2006: Up to C$36,378 15 per cent C$36,378 C$72,756 22 per cent C$72,756 C$118,285 26 per cent Over C$118,285 29 per cent Thresholds are indexed to inflation. Individuals can be subject to an alternative minimum federal income tax. The base for minimum tax purposes differs from the normal tax base. The individual multiplies their income for minimum tax purposes by the lowest federal tax rate (15 per cent). If the resulting tax exceeds normal federal tax payable, the taxpayer must pay the minimum tax amount.	Basic credit: All taxpayers qualify for a basic personal tax credit of C$1,356 in 2006. Other credits include spousal credit for spousal income, disabled dependent's credit, an age credit, disability credit, tuition and education credit, transfer of spouse's credits, medical expenses credit, charitable donations, and pension credits. Credits of 15 per cent are available for contributions to the Canada or Quebec Pension Plans and their Employment insurance premiums, but not exceeding the maximum premium allowed.

Appendix table 4.5.4: OECD-10 — National personal income tax rates and credits (continued)

Country	Tax rates	Credits
Ireland	Individuals can determine, for national income tax purposes, if they are taxed separately or jointly. The standard and higher rates of income tax are 20 and 42 per cent respectively. Tax at the standard rate is chargeable on income up to the standard rate cut-off point. Standard cut-off point Single/widower: €32,000 Married couple (one income): up to €41,000 Married couple (two incomes): up to a max of €64,000 (threshold is increased by the amount of the lowest income to a maximum of €23,000) One parent family: €36,000 Taxpayers with income below twice the relevant exemption limit (relevant exemption limit is €5,210 for singles and €10,420 for married persons) pay a lower rate of tax known as the marginal relief tax. The marginal relief limits the tax burden to 40 per cent.	A single person is entitled to a credit of €1,630 per year. The married person's credit is €3,260 per year. Other credits are available where taxpayers are eligible, such as the PAYE credit, widow's credit, dependent relative's credit, and one parent family credit.
Japan	The formula is income A-B-C, where A is the taxable income by tax rate, B is standard deduction, and C is proportional tax reduction. Tax rate brackets: Taxable Income Over / Not Over — Tax Rate (per cent) A — Deductible amount of each bracket B 0 / ¥3.3M — 10 — 0 ¥3.3M / ¥9M — 20 — ¥0.33M ¥9M / ¥18M — 30 — ¥1.23M ¥18M / — 37 — ¥2.49M Proportional tax reduction (C): 10 per cent of A-B (ceiling ¥125,000). Tax rate changes have been proposed to take effect from 1 January 2007 that are yet to be legislated.	

Appendix table 4.5.4: OECD-10 — National personal income tax rates and credits (continued)

Country	Tax rates	Credits
Netherlands	For 2006, Box 1 income rates Up to €17,046: 34.15 per cent (2.45 per cent income tax, 31.7 per cent National insurance contributions) €17,046 – €30,631: 41.45 per cent (9.75 per cent income tax, 31.7 per cent National insurance contributions) €30,631 – €52,228: 42 per cent (income tax) Over €52,228: 52 per cent (income tax) Thresholds are indexed to inflation. Box 2 income is flat at 25 per cent. In Box 3, the net yield of 4 per cent is taxed at a flat rate of 30 per cent, resulting in a tax of 1.2 per cent on the net assets.	For 2006 income year: General Tax Credit for under 65 of €1990; Employment Tax Credit of €1,357. There are other credits available, such as the child tax credit and the combination tax credit.
New Zealand	Tax rate brackets: Up to NZ$38,000: 19.5 per cent NZ$38,000 – NZ$60,000: 33 per cent Over NZ$60,000: 39 per cent Fringe benefits can either be calculated at a flat rate of 64 per cent or on a multi-rate based on the employee's remuneration.	The maximum low income rebate is NZ$427.50 which iscalculated at 4.5 cents in the dollar for income up to NZ$9,500. Where income is in the range NZ$9,500 to NZ$38,000, the maximum rebate is reduced by 1.5 cents for every dollar over NZ$9,500.
Spain	Tax rate brackets for the 2006 income year: Up to €4,162: 15 per cent €4,162 – €14,358: 24 per cent €14,358 – €26,842: 28 per cent €26,842 – €46,818: 37 per cent Over €46,818: 45 per cent Since 1 January 2005, the thresholds have been indexed by 2 per cent to mitigate the effect of inflation.	

Appendix table 4.5.4: OECD-10 — National personal income tax rates and credits (continued)

<table>
<tr><th>Country</th><th>Tax rates</th><th>Credits</th></tr>
<tr><td>Switzerland</td><td>The total tax burden is limited to 11.5 per cent.

Tax rate brackets in 2006 for married couples living together, and to widowed, separated, divorced or single persons living with children who are minor or studying at their expense:
<table>
<tr><th colspan="2">Taxable Income</th><th>Tax on lower amount</th><th>Rate on excess</th></tr>
<tr><td>0</td><td>CHF29,100</td><td>0</td><td></td></tr>
<tr><td>CHF29,200</td><td>CHF47,800</td><td>CHF25</td><td>1</td></tr>
<tr><td>CHF47,900</td><td>CHF54,800</td><td>CHF212</td><td>2</td></tr>
<tr><td>CHF54,900</td><td>CHF70,800</td><td>CHF352</td><td>3</td></tr>
<tr><td>CHF70,900</td><td>CHF85,000</td><td>CHF832</td><td>4</td></tr>
<tr><td>CHF85,100</td><td>CHF97,300</td><td>CHF1,400</td><td>5</td></tr>
<tr><td>CHF97,400</td><td>CHF108,000</td><td>CHF2,015</td><td>6</td></tr>
<tr><td>CHF108,100</td><td>CHF116,900</td><td>CHF2,657</td><td>7</td></tr>
<tr><td>CHF117,000</td><td>CHF123,900</td><td>CHF3,280</td><td>8</td></tr>
<tr><td>CHF124,000</td><td>CHF129,200</td><td>CHF3,840</td><td>9</td></tr>
<tr><td>CHF129,300</td><td>CHF132,800</td><td>CHF4,317</td><td>10</td></tr>
<tr><td>CHF132,900</td><td>CHF134,600</td><td>CHF4,677.99</td><td>11</td></tr>
<tr><td>CHF134,700</td><td>CHF136,400</td><td>CHF4,875</td><td>12</td></tr>
<tr><td>CHF136,500</td><td>CHF843,500</td><td>CHF5,091</td><td>13</td></tr>
<tr><td>CHF843,600</td><td></td><td>CHF97,014</td><td>11.5</td></tr>
</table>
If taxable income exceeds CHF843,600, a flat rate of 11.5 per cent applied to the whole income for both types of taxpayers.

Switzerland is required to make a threshold adjustment after the cumulative inflation rate has increased by at least 7 per cent since the last adjustment.</td><td></td></tr>
<tr><td>United Kingdom</td><td>Tax rate brackets income and capital gains
<table>
<tr><td>Up to</td><td>£2,090</td><td>10 per cent</td></tr>
<tr><td>£2,090</td><td>£32,400</td><td>22 per cent</td></tr>
<tr><td>Over</td><td>£32,400</td><td>40 per cent</td></tr>
</table>
Thresholds are indexed in line with inflation unless the Parliament specifies this is not to occur</td><td>Low income families may be entitled to a working tax credit or child tax credit.</td></tr>
</table>

Appendix table 4.5.4: OECD-10 — National personal income tax rates and credits (continued)

Country	Tax rates	Credits
United States	The tax thresholds vary depending on the filing status of a taxpayer. There are four categories of taxpayer: married persons filing jointly, heads of households and unmarried and married persons filing jointly. The rates that apply are the same. For unmarried (single taxpayers) the tax rate brackets for 2006 are as follows: Up to US$7,550 10 per cent US$7,550 US$30,650 15 per cent US$30,650 US$74,200 25 per cent US$74,200 US$154,800 28 per cent US$154,800 US$336,550 33 per cent Over US$336,550 35 per cent Individuals are subject to alternative minimum tax if the alternative minimum tax exceeds their regular tax. The base for the alternative minimum tax is slightly different. To calculate the alternative minimum tax the taxpayer determines the alternative minimum taxable income (AMTI) and subtracts the AMTI exemption amount. Thresholds are indexed annually for inflation.	Low income workers with dependants are entitled to a refundable earned income credit.

Source: various, see Chapter 1 (1.4.1).

Appendix table 4.5.5: OECD-10 sub-national personal income taxes

Country	Base	Rates	Credits
Australia	No sub-national personal income taxes.		
Canada	For all provinces, except Quebec, the federal government collects both individual and corporate tax on behalf of the provinces. In consideration, the provinces use the federal income tax base. Provinces also impose provincial surtaxes on provincial tax or income above specified amounts. The OECD uses the Province of Ontario as the representative sub-central government, as this is the most populous province.	The top rate varies across the provinces from 24 per cent in Quebec to 10 per cent in Alberta. Ontario's basic tax rate brackets from 1 January 2006 are: Up to C$34,758 — 6.05 per cent C$34,758 — C$69,517 — 9.15 per cent Over C$69,517 — 11.16 per cent The thresholds are indexed to inflation. Ontario also levies a surtax with rates of 20 per cent and 36 per cent depending on the taxpayer's income.	Ontario has a basic income tax credit of C$8,377. Credits for the Canada Pension Plan and for Employment Insurance premiums.
Ireland	No sub-national personal income taxes.		
Japan	Sub-national income taxes in Japan consist of a prefectural inhabitants' tax levied by prefectures and a municipal inhabitants' tax levied by cities, towns and villages. Standard per capita tax rate of prefectural inhabitants' is ¥1,000. Standard per capita tax rate of Municipal inhabitants' is ¥2,000 to ¥3,000 depending on the size of the municipality. Tax liability is obtained by multiplying the taxable income by tax rate (A) and deducting the amount (B). In addition, Proportional Reduction (C).	Proportional tax reduction (C): 7.5 per cent of calculated amount, that is A-B (ceiling ¥20,000). Taxable Income Over / Not Over — Tax Rate (per cent) A — Deductible amount of each bracket B Prefectual Inhabitants' tax 0 / ¥7M — 2 — 0 ¥7M / — 3 — ¥0.07M Municipal Inhabitants' tax 0 / ¥2M — 3 — 0 ¥2M / ¥7M — 8 — ¥0.1M ¥7M / — 10 — ¥0.24M Tax rate changes are proposed for 1 January 2007. Combined flat rate of 10 per cent.	
Netherlands	No sub-national personal income taxes.		
New Zealand	No sub-national personal income taxes.		
Spain	No sub-national personal income taxes, however, we have received conflicting information on this issue.		

Appendix table 4.5.5: OECD-10 sub-national personal income taxes (continued)

Country	Base	Rates	Credits
Switzerland	There are no rules on whether worldwide or only domestic income is taxable. Taxable income includes all recurrent and non-recurrent income from dependent and independent activities and from movable and immovable property. It also includes pensions and social security benefits. Various forms of income are exempt, including damages for mental or physical pain suffered. The OECD uses Zurich as the example cantonal. For all cantons, all expenses that are necessary in order to realise taxable income are deductible. Social security contributions and contributions to approved savings plans, premiums for health, private accident and life insurances up to certain limits are all deductible. The standard deduction is also available with higher amounts for married couples and amounts vary from canton to canton.	The cantons may set their own tax rates. The cantonal laws must provide tax reductions for unseparated spouses, as well as for widowed, separated, divorced and single taxpayers maintaining children or needy persons. Zurich has 13 different tax brackets at a maximum rate of 13 per cent. Municipal income taxes are levied in the form of a surcharge on the cantonal tax. The surcharge is equal to the basic cantonal tax, multiplied by a municipal coefficient. The coefficient for the capital city Zurich in the canton of Zurich is 1.22 (for 2005).	
United Kingdom	No sub-national personal income taxes.		
United States	Income tax is imposed by most states (some using a progressive) and by some municipalities but it is deductible for federal tax purposes for taxpayers that itemise deductions. Some states also levy a sales tax. Personal allowances and standard deductions vary from state to state.	State and local income tax rates vary from 9.5 per cent in Vermont to 3 per cent in Illinois. New York imposes both state and city income taxes. California imposes state income tax. Texas does not levy state income tax. Michigan has a flat income tax rate of 3.90 per cent. The average worker in the cameo analysis of the tax wedge and net personal average tax rate is assumed to live in Detroit, Michigan. Most states do not index their thresholds.	Credits vary from state to state.

Source: various, see Chapter 1 (1.4.1).

Appendix table 4.5.6: OECD-10 payroll taxes

Country	Payroll taxes
Australia	States levy payroll taxes. The OECD uses NSW as the indicative state. In NSW, payroll tax applies at a 6 per cent flat rate above the A$600,000 firm wages threshold.
Canada	n/a
Ireland	n/a
Japan	n/a
Netherlands	n/a
New Zealand	n/a
Spain	n/a
Switzerland	n/a
United Kingdom	n/a
United States	n/a

Source: various, see Chapter 1 (1.4.1).
Note: payroll taxes that are earmarked for social security expenditure are included in employer social security contributions (refer to Table 4.7).

Appendix table 4.5.7: OECD-10 social security contributions (SSC)

Country	Employee SSC	Employer SSC	Self-employed SSC
Australia	No social security contributions levied.		
Canada	Employment insurance — C$729 per week. Canada Pension Plan (CPP) — 4.95 per cent of income up to a maximum of C$1,910.70 for income above C$3,500.	CPP — 4.95 per cent for earnings above C$3,500 up to a maximum of C$1,910.70. Payroll taxes levied in some jurisdictions. Ontario levy 1.95 per cent to Employer Health Tax if payroll exceeds C$400,000. Employers also contribute to provincial workers' compensation plan. Rates vary for example in Ontario employers in C to K industry pay an average of 2.61 per cent.	The self employed contribute to CPP at rate of 9.9 per cent.
Ireland	Social insurance is levied on all earned income by employed and self-employed persons. Employees pay 4 per cent social insurance between certain incomes between €6,604 and €46,600. A health levy is charged at 2 per cent on all income.	Employer contributions are payable as a percentage of gross employee earnings less allowable superannuation contributions different categories. The total rate is 10.75 per cent on all employment income (no ceiling).	Self-employed persons pay 3 per cent social insurance on all income. A health levy contribution of 2 per cent is also payable on all income by all persons whose annual income is at least €18,512.
Japan	Pension: 7.144 per cent of total remuneration, up to the insurable ceiling of ¥620,000 monthly and ¥1,500,000 for a one off payment. The premium rate for the employee's pension is raised by 0.354 per cent every year from October 2004, reaching a maximum of 18.30 per cent in 2017 onward. Sickness: 4.1 per cent of total remuneration, up to insurable ceiling of ¥980,000 (monthly). Unemployment: 0.8 per cent of gross remuneration. Workmen's accident compensation insurance: 0.45 per cent of gross yearly remuneration. Public nursing care: 0.615 per cent of monthly remuneration and bonus for employer and employee aged over 40 up to a maximum of ¥6,027 (note the premium rate of 0.615 per cent applied from 1 May 2006).	Pension: 7.144 per cent of total remuneration, up to the insurable ceiling of ¥620,000 (monthly) and ¥1,500,000 for a one off payment. Sickness: 4.1 per cent of total remuneration, up to insurable ceiling of ¥980,000 (monthly). Unemployment: 1.15 per cent of gross remuneration. Workmen's accident compensation insurance: 0.45 per cent of gross yearly remuneration. Public nursing care: 0.615 per cent of monthly remuneration and bonus for employer and employee aged over 40 up to a maximum of ¥6,027 (note the premium rate of 0.615 per cent applied from 1 May 2006).	National pension is ¥13,860 per month. The monthly premium is raised by ¥280 every year from April 2005 and will be fixed at ¥16,900 in 2017 and onward.

Appendix table 4.5.7: OECD-10 social security contributions (SSC) (continued)

Country	Employee SSC	Employer SSC	Self-employed SSC
Netherlands	Tax and national social security contributions are levied as an aggregate amount. Contributions are: • Old Age Pension: 17.9 per cent of first and second tax brackets (Box 1). Individuals 65 and over are exempt. • Widows and orphans pension: 1.25 per cent of first and second tax brackets (Box 1). • Exceptional Medical expenses and disability: 12.55 per cent of first and second tax brackets (Box 1). • Also levies unemployment and public insurance for medical care social security contributions.	Netherlands levies employer social security contributions for the general unemployment fund, unemployment fund for industrial insurance associations, invalidity, public insurance for medical care.	
New Zealand	No social security contributions are levied.		
Spain	General contribution system has a minimum and maximum contribution base that is adjusted annually. For 2006 the maximum monthly base is €2,897.70. Employed persons General risks — 4.7 per cent Unemployment insurance — 1.6 per cent Professional training — 0.1 per cent	General risks — 23.6 per cent Unemployment — 6.0 per cent Wages fund — 0.4 per cent Professional training — 0.6 per cent Employers must pay a work accident insurance which varies depending on job type, for example 0.99 per cent for office work, 13.5 per cent for airlines.	The self-employed taxpayers' effective rate is 29.8 per cent.
Switzerland	The employer withholds employee's contribution. Old age and survivor insurance — 4.20 per cent Disability insurance — 0.7 per cent Military compensation — 0.15 per cent Unemployment insurance — 1 per cent however, no contribution is levied on income in excess of CHF106,800. Health insurance is mandatory; however, it is the responsibility of the individual. Non-accident insurance premiums are paid by the employees and vary between 1 per cent and 4 per cent. Employees with annual wages above CHF19,350 are also subject to a company's pension scheme. Contributions and insured salary vary depending on the pension scheme.	Old age and survivor insurance — 4.20 per cent Disability insurance — 0.7 per cent Military compensation — 0.15 per cent Unemployment insurance — 1 per cent however, no contribution is levied on income in excess of CHF 106,800.	Old age and survivor insurance — 7.8 per cent Disability insurance — 1.4 per cent Military compensation — 0.3 per cent Lower rates apply for self-employed persons with gross income between CHF7,800 and 50,700.

Appendix table 4.5.7: OECD-10 social security contributions (SSC) (continued)

Country	Employee SSC	Employer SSC	Self-employed SSC
United Kingdom	National Insurance contributions — 11 per cent for earnings between £94 and £630 and 1 per cent on all earnings above £630. Reductions to 9.4 per cent available if the employees participates in an employer-sponsored pension scheme or a personal pension plan, which contract the employee out of the State Earnings Related Pension Scheme (SERPS).	Employers' contributions of 12.8 per cent for earnings above £94 per week. For employees who are contracted out there is a rebate of 3.5 per cent on earnings between £82 and £630 per week.	Self-employed persons contribute at flat rate of £2.10 per week. There is a small earnings exemption limit of £4,345.
United States	Two social security taxes are imposed by the national government: the old age, survivors and disability insurance tax (OASDI) and the hospital insurance tax (Medicare). The tax is imposed in equal percentages on the employer and employee. OASDI: 6.2 per cent imposed on wages up to a maximum of US$94,200 in 2006. Medicare: 1.45 per cent on employee's wages.	OASDI: 6.2 per cent imposed on earnings up to US$94,200 in 2006. Medicare: 1.45 per cent on all employees' wages. Unemployment Tax: 6.2 per cent on earnings up to US$7,000. Employers who pay the state unemployment tax, on a timely basis, receive an offset credit of up to 5.4 per cent.	Self-employed taxpayers are responsible for paying both the employee and employer OASDI and Medicare contributions.

Source: various, see Chapter 1 (1.4.1).

APPENDIX 4.6: WAGE AND SALARY TAXATION DATA

Appendix table 4.6.1: Gross wage earnings in national currency and in US dollars for an average worker

Country	Gross wage earnings in national currency	Gross wage earnings in US dollars using purchasing power parities
Australia	51,169	36,851
Austria	33,624	36,934
Belgium	36,396	41,101
Canada	40,341	31,297
Czech Republic	221,886	15,229
Denmark	328,390	38,454
Finland	32,722	35,035
France	30,219	33,619
Germany	41,074	44,086
Greece	18,339	25,808
Hungary	1,778,552	13,681
Iceland	2,949,759	32,113
Ireland	31,663	31,056
Italy	22,759	27,060
Japan	4,953,747	38,235
Korea	28,729,826	37,702
Luxembourg	40,500	40,984
Mexico	79,997	10,688
Netherlands	37,759	41,560
New Zealand	40,949	27,274
Norway	379,934	38,509
Poland	30,000	16,232
Portugal	13,299	20,148
Slovak Republic	216,780	12,478
Spain	20,701	26,451
Sweden	309,854	33,154
Switzerland	71,595	40,694
Turkey	15,256	18,609
United Kingdom	28,571	46,091
United States	31,666	31,666

Appendix table 4.6.2: Top marginal tax rate and threshold

	Combined top marginal tax rate(a)	All-in top marginal rate	Threshold multiple (average production wage)
Slovak Republic	2.9	19.0	0.5
Hungary	56.0	69.5	0.8
Ireland	42.0	48.0	0.9
Denmark	55.0	63.0	1.0
Luxembourg	33.9	47.9	1.0
Belgium	45.1	59.3	1.1
Mexico	22.5	32.1	1.2
United Kingdom	40.0	41.0	1.3
Australia (2004-05)	48.5	48.5	1.4
Germany	44.3	44.3	1.4
Netherlands	52.0	52.0	1.4
Iceland	40.2	40.2	1.4
New Zealand	39.0	39.0	1.5
Greece	33.6	49.6	1.5
Sweden	56.6	56.6	1.5
Finland	49.9	56.5	1.9
Czech Republic	28.0	40.5	1.9
Austria	42.7	42.7	2.1
Norway	43.5	51.3	2.1
Australia (2006-07 on)	48.5	48.5	2.2
Turkey	26.1	41.1	2.3
Spain	45.0	45.0	2.6
France	36.5	48.6	2.7
Canada	46.4	46.4	2.9
Poland	26.2	51.8	3.1
Switzerland	37.8	47.9	3.6
Korea	35.6	38.2	3.6
Japan	47.1	47.9	4.5
Portugal	35.6	46.6	4.6
Italy	44.1	44.1	4.8
United States	41.3	42.7	10.6
Unweighted average	39.9	46.7	2.4
Weighted average	41.4	44.5	5.6

Source: OECD Tax database (preliminary data) and Australian Treasury estimates.

(a) Combined top marginal tax rate includes the national government and sub-national government (top marginal) rate, calculated as the additional national and sub-national government personal income tax resulting from a unit increase in gross wage earnings. The combined rate takes account of the effects of tax credits, the deductibility of sub-central taxes in central government taxes etc.

Chapter 5

Corporate taxation

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5. CORPORATE TAXATION

SUMMARY

In recent decades there has been a clear trend decline in the OECD-30 countries' statutory corporate tax rates. From 2000 (the first year with comparable data combining rates from national and sub-national levels across countries), the fall in Australia's corporate tax rate has exceeded those in the OECD-30 average and the OECD-10 average.

The decrease in statutory corporate tax rates across the OECD-30 has not led to a reduction in corporate tax receipts as a share of GDP because reductions in rates have often been partnered by a broadening of the tax base. In addition, there has been a rapid growth in company profits as a share of GDP.

Australia's effective corporate tax rate has been relatively stable over the period since 1965, and at 20 per cent in 2004-05 was slightly above the historic average.

Classification issues make comparisons of the headline corporate income tax burden difficult. Subject to these limits, Australia has the highest corporate tax burden of the OECD-10 at 5.3 per cent of GDP, compared with the unweighted average of 3.4 per cent.

Australia's 30 per cent statutory corporate rate is in line with the OECD-10 — it has the equal fourth lowest rate of the OECD-10 and is slightly below the OECD-10 average of 30.8 per cent. Australia's 30 per cent statutory corporate tax rate is slightly above the OECD-30 unweighted average of 28.5 per cent and significantly below the weighted average of 35.6 per cent.

Australia has the equal lowest value of depreciation allowances of the OECD-10 countries if the value is measured as the present value of depreciation as a proportion of initial purchase price.

Despite moves in many OECD countries for a more neutral treatment between debt and equity financing of investments, there remain major differences in the effective marginal tax rates (EMTRs) of most corporate tax systems' investments funded by debt or by equity.

The report also compares EMTRs and effective average tax rates (EATRs) in the corporate taxation area. Australia has the third highest EMTR (24.3 per cent) of the OECD-10 (except New Zealand) for a marginal investment in plant financed by equity. The average is 21.5 per cent.

- For a similar investment financed by debt, Australia has the second highest EMTR (-23.1 per cent), compared with the average of -31.7 per cent.

- When looking at investment in industrial buildings, the data show that Australia has the equal second lowest EMTR on equity financed investment.

Of the OECD-10, Australia has the fourth highest EATR (26.2 per cent) for an investment in plant and equipment financed by equity, with the average being 25.2 per cent.

- For a similar investment financed by debt Australia has the second highest EATR (6.9 per cent) with the average being 5.6 per cent.
- When looking at investment in industrial buildings, the data show that Australia has the equal second lowest EATR on equity-financed investment.

A number of countries, including Australia, have lower corporate rates or concessions for smaller companies or for start-ups.

Half of the OECD-10 countries permit loss carry back and over half allow the amortisation of goodwill, neither of which Australia permits.

With the exception of New Zealand, all of the OECD-10 countries impose some general form of corporate capital gains tax (CGT). There are significant variations in the rate of CGT depending on the nature and level of the shareholding.

5.1 Introduction

As discussed in Chapter 4, most aggregate measures of the corporate tax burden based on proportions of GDP have limited value because of statistical classification issues.

Data on average corporate tax rates are potentially more useful, but there are difficulties in making international comparisons. This is because of major differences in how countries classify corporate revenues and corporate profits and also differences in the way countries prepare national accounts (for example, in the case of Germany, total accrual taxation revenue in 2003 was €768 million according to *Revenue Statistics*, but €888 million on a national accounts basis).

Given these limits, there is a need to go beyond some of the aggregate measures to examine the impacts of corporate taxation on actual investment decisions and international competitiveness. In the remainder of this chapter, after examining the aggregate measures and their limits, there is a comprehensive discussion of corporate tax rates.

There is also a brief discussion of the conceptual choice of a corporate tax base because of the potential trade-offs between the corporate tax base and the corporate tax rate, as well as some efficiency differences between tax bases.

Some forward looking numerical approaches are then suggested, based around effective marginal tax rates (EMTRs) and effective average tax rates (EATRs) derived from particular international studies that look at a range of different investments and financing options.

There are a number of further insights from the detailed comparator tables in this chapter on depreciation arrangements including the treatment of goodwill, treatment of company losses, treatment of start-up companies and taxation of corporate capital gains.

5.2 Broad International comparisons

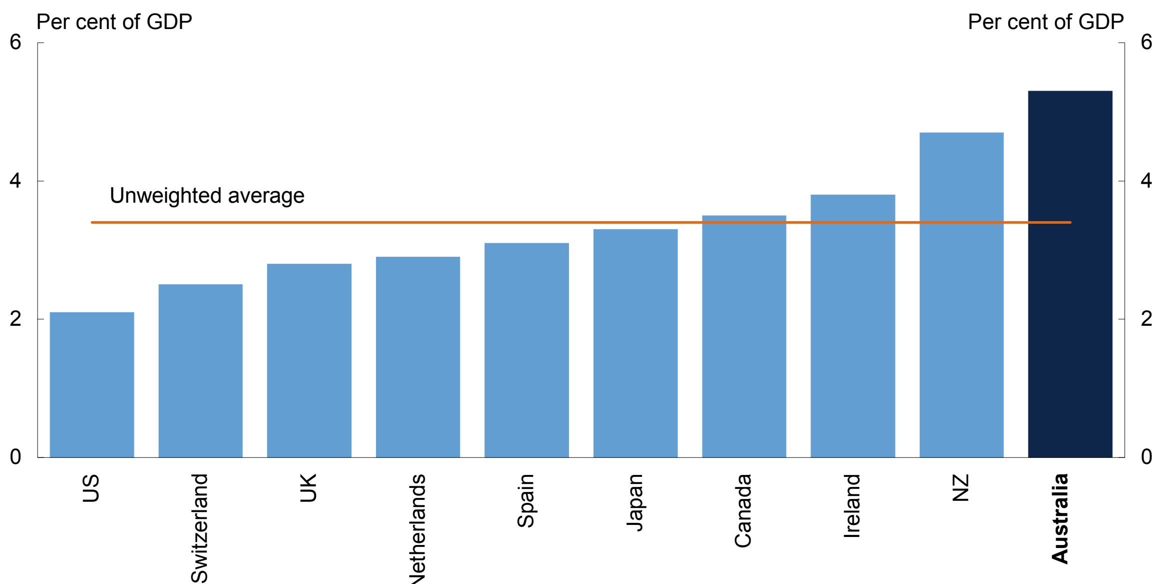
5.2.1 Corporate income tax burden

As discussed in detail in Appendix 4.1, classification issues make comparisons of headline corporate income tax burdens difficult (this is the measure most frequently used in commentary about corporate tax burden). In particular, care should be exercised when analysing income tax data that have been disaggregated into personal and corporate components. Some of the difficulties with disaggregating the overall income tax measure include differences between countries in:

- the levels of incorporation;
- the ways that personal and company tax systems are integrated (for instance, with imputation systems such as Australia's, the OECD acknowledges that the question arises as to whether the company tax underpinning dividend franking credits should be allocated to individuals rather than corporations);
- the way retirement income systems are constructed;
- the way taxes on resource rents are collected; and
- the incentives to distribute or retain earnings (retained earnings may face more concessional CGT rates in some countries).

Notwithstanding these caveats, Australia's corporate tax burden as a proportion of GDP is compared with the average for the OECD-10 in Chart 5.1.

Chart 5.1: Direct taxation in respect of companies[(a)]
OECD-10, taxation revenue as a proportion of GDP,
ordered by tax burden, 2003



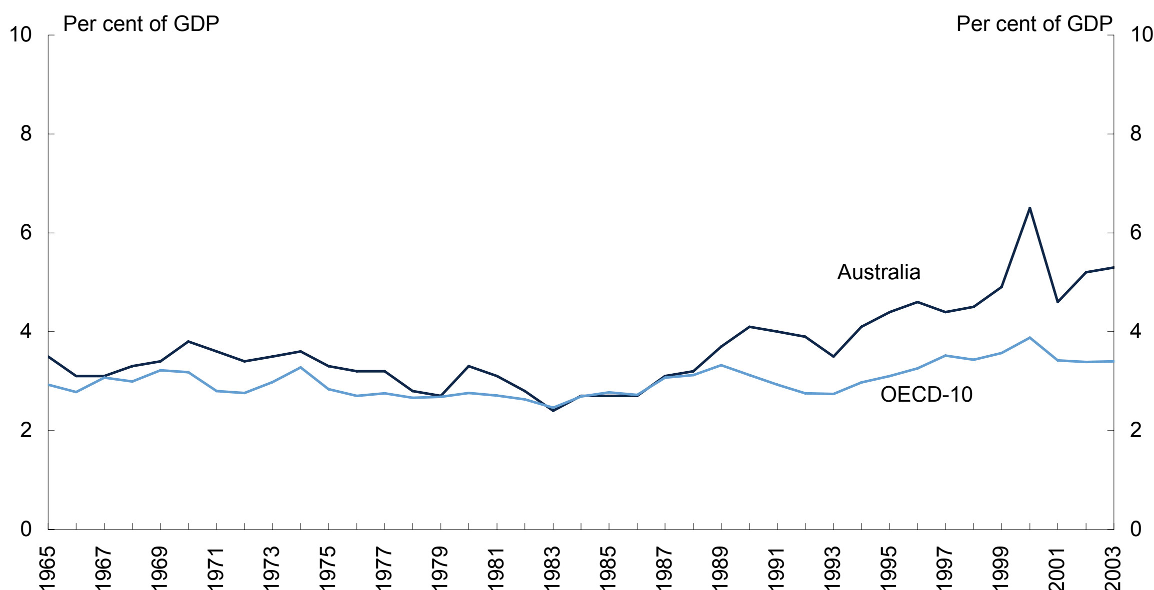
(a) The OECD notes that, for the purpose of international comparison, there are significant risks in relying on disaggregated data, especially in disaggregating classification 1000 (income taxation revenue).
Source: OECD *Revenue Statistics*, 2005.

Australia has the highest corporate tax burden of the OECD-10 at 5.3 per cent of GDP, compared with the unweighted average of 3.4 per cent (Chart 5.1). New Zealand (4.7 per cent) also has a high tax burden, but it may be affected by some of the same classification issues as Australia — in particular, its imputation system is similar to Australia's. The low tax burden for the United States (2.1 per cent) stands in contrast to its relatively high statutory tax rate.

Australia's corporate tax burden was relatively stable for the period from 1965 to 1988 and broadly in line with the average for the OECD-10 during that time (Chart 5.2). Since 1988, the Australian corporate tax burden has increased from a little under 4 per cent of GDP to a little over 5 per cent. In comparison, the average corporate tax burden for the OECD-10 remained relatively stable over the entire period — there has been a slight increase in the corporate tax burden for the OECD-10 since the mid-1990s, but it is not as discernable as the increase for Australia.

Chart 5.2: Australian corporate tax burden in perspective

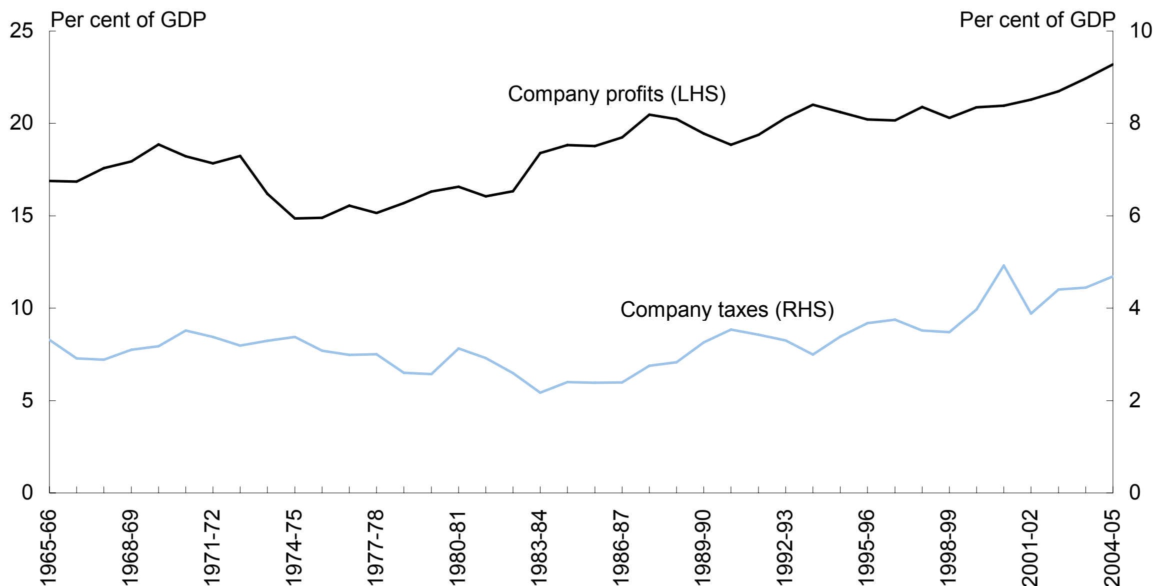
OECD-10, total corporate taxation revenue as a proportion of GDP, 1965-2003



Source: OECD *Revenue Statistics*, 2005.

Part of the explanation for the increase in Australia's tax burden is the rapid growth in company profits as a share of GDP (Chart 5.3). Company profits are generally measured in the national accounts as gross operating surplus.

Chart 5.3: Corporate tax burden and corporate gross operating surplus
Australia, corporate profits and taxation revenue as a proportion of GDP, 1965-66 to 2004-05



Source: Australian Treasury estimates.

The share of Australian company profits in GDP has increased by about 40 per cent, from 16.9 per cent of GDP in 1965-66 to 23.2 per cent in 2004-05 — an increase of 6.3 percentage points. This gain has been entirely at the cost of the declining share of gross mixed income in GDP. Gross mixed income consists broadly of business, farming and investment activities carried out by entities other than corporations — that is, mostly individuals. This long run shift from mixed income to company income partly reflects the incorporation of small businesses.

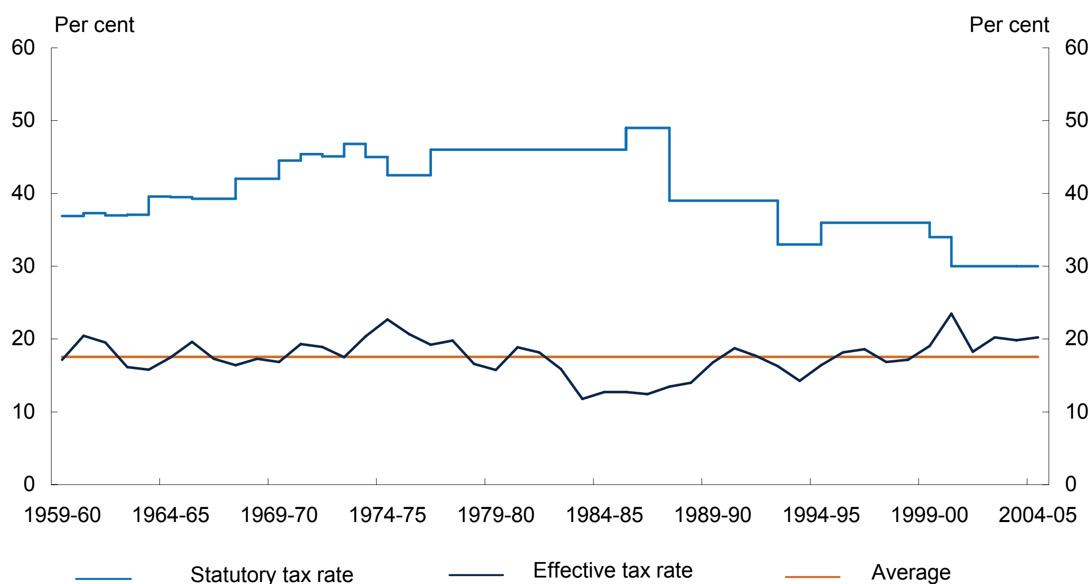
5.2.2 Effective corporate tax rates

An alternative measure of the corporate tax burden is the effective rate of corporate tax. The effective rate is total corporate taxation revenue taken as a proportion of corporate gross operating surplus (broadly, corporate profits) from the national accounts.

The effective corporate tax rate is a potentially useful measure of corporate tax burden. It provides information about the size of the corporate tax base when compared with the statutory corporate tax rate (currently 30 per cent in Australia), and it also incorporates changes over time in the share of corporate profits in total GDP, which the aggregate corporate tax burden does not.

The effective corporate tax rate for Australia since 1959-60 is shown in Chart 5.4. The statutory corporate tax rate is also included to show how the statutory rate and the effective rate can move in different directions. The tax base is broader when the two rates converge, and the base narrows as the two rates diverge. Even though there have been significant changes in statutory rates, it is interesting to note that the effective corporate tax rate has been relatively stable over the entire period.

Chart 5.4: Statutory and effective corporate tax rates[(a)]
Australia, 1959-60 to 2004-05



(a) Pre 1974-75 there were separate tax rates for public and private companies. The chart is based on an average of the two rates.
Source: Australian Treasury estimates.

Australia's statutory corporate tax rate reached a high point of 49 per cent in the late 1980s and has been reduced several times since then. The effective corporate tax rate has been relatively stable over the period since 1965 and at 20 per cent in 2004-05 is slightly above the historic average.

Estimates of the effective corporate tax rate could be extended to other OECD countries, but the OECD does not publish effective tax rate data and there are classification issues and significant differences in the national accounts treatment of elements of company profits.

5.3 STATUTORY CORPORATE TAX RATES AND BASES

Australia's corporate income tax system seeks to fulfil two fundamental roles as:

- a (withholding) tax on the income of Australian residents received from an Australian resident company; and
- a tax on the (Australian source) income of foreigners, earned from an Australian company or the Australian branch of a foreign company.

The effective corporate tax rate can be split into two key parts — the tax rate and the tax base.

The statutory corporate tax rate is important to domestic corporations because it is one determinant of their after-tax income. Corporations then divide this after-tax income between distributions to their shareholders and retained profits. The latter are available for financing (among other things) business expansion and investment. The statutory corporate tax rate also affects the production costs of domestic corporations.

The other determinant of a corporation's after-tax income is the corporate tax base which may be structured in several ways (see Appendix 5.1: Corporate Base Options). It also depends on a country's depreciation arrangements, corporate tax exemptions and concessions. These arrangements vary from country to country and limit the usefulness of statutory corporate rates as a basis for international comparisons.

5.4 STATUTORY CORPORATE TAX RATES

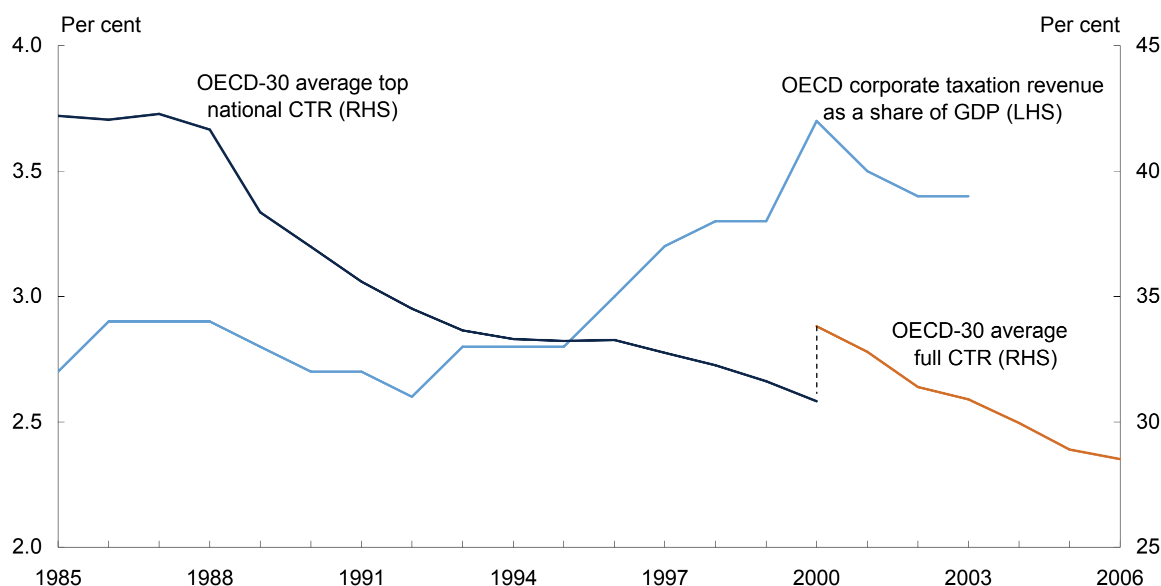
Although the statutory corporate tax rate has its limitations in making international comparisons of the corporate tax burden, it nevertheless has a number of useful features, especially where information is available on the combined impact of national and sub-national government taxes.

Only the national corporate tax rate information is readily available prior to 2000. After 2000, information is available on the 'full' rate from all levels of government. As the full rate is a better measure for international comparisons, it will be used wherever possible (this explains the 'break' in Chart 5.5 — the size of the break of 3 percentage points indicates the importance of using the full rate for international comparisons).

In recent decades there has been a clear trend decline in countries' top national statutory corporate tax rates (Chart 5.5). Australia's rate reductions have been slightly greater than the OECD-30 unweighted average decline, with the corporate tax rate falling from 49 per cent in 1987 to 30 per cent from 1 July 2001.

This trend decline in OECD-30 countries looks set to continue, with the Spanish government recently finalising its proposal to cut gradually the corporate tax rate from 35 per cent to 30 per cent by 2011 and the Netherlands government in its 2006 Budget reducing its top corporate tax rate by 1.9 percentage points to 29.6 per cent.

Chart 5.5: Historical trends in statutory corporate tax rates and corporate taxation revenue (unweighted)[(a)]
OECD-30, 1985-2006



(a) Rates are top national statutory corporate tax rates until 2000 and full corporate tax rates post 2000. Averages are unweighted.
Source: OECD Tax Database; KPMG (various years); OECD (2005); Deloitte (2006); various country websites.

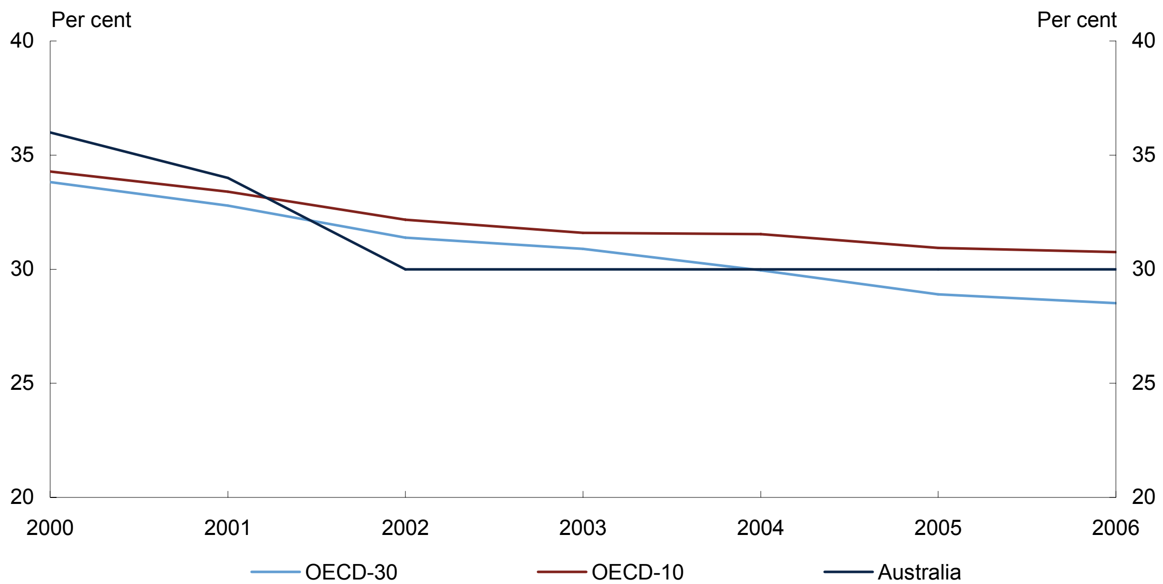
The OECD top national average statutory corporate tax rate declined from 42.2 per cent in 1985 to 30.8 per cent in 2000, measured on an unweighted basis (from 43.4 per cent to 33.5 per cent on a GDP-weighted basis). The OECD-30 full corporate average statutory tax rate declined from 33.8 per cent in 2000 to 28.5 per cent in 2006 measured on an unweighted basis (from 38.7 per cent to 35.6 per cent on a GDP-weighted basis).

Australia's statutory corporate tax rate increased from 46 per cent in 1985 to 49 per cent in 1987 before declining to 36 per cent in 1995-96 (see Chart 5.4), to 34 per cent on 1 July 2000 and to 30 per cent on 1 July 2001.

Chart 5.5 shows that the decrease in statutory corporate tax rates has not led to a reduction in corporate tax receipts in OECD countries as a share of GDP. In 1985, corporate taxation revenue was 2.7 per cent of GDP and in 2003 the ratio had increased to 3.4 per cent of GDP. This increase in corporate taxation revenue as a proportion of GDP has occurred because reductions in rates have often been partnered by a broadening of the tax base and the rapid growth in company profits as a share of GDP. In Australia's case, this partly reflects a significant shift of income from unincorporated businesses towards the corporate sector.

The decrease in statutory corporate tax rates has been attributed by some to the competition between countries to attract highly mobile international capital. Others have noted that in the European Union the decrease in corporate tax rates has been accompanied by a broadening of the corporate tax base, implying that attracting investment is not the main goal of European tax policy. Rather, reductions in the statutory corporate tax rate may be designed to diminish corporations' incentives for shifting income to their affiliates in low-tax countries via transfer pricing (Sullivan 2006, p 440).

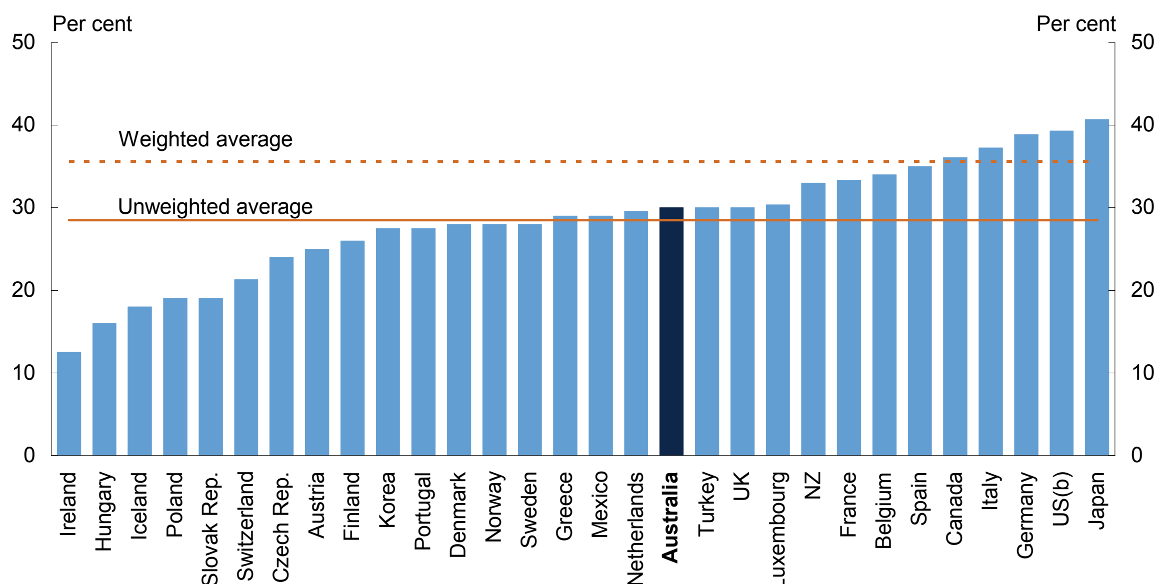
Chart 5.6: Full statutory corporate tax rates[a]
OECD-30 and OECD-10 countries (unweighted average), Australia, 2000-2006



(a) Rates are full (national, sub-national and surcharge) statutory corporate tax rates.
Source: OECD Tax Database; KPMG (various years); Deloitte (2006); various country websites.

At the beginning of the year 2000, Australia's corporate tax rate was 36 per cent while the OECD-30 average full statutory corporate tax rate was 33.8 per cent and OECD-10 average was 34.3 per cent. Over the period 2000-2006 Australia's corporate tax rate declined by 6 percentage points while the OECD-30 declined by 5.3 percentage points and the OECD-10 by 3.5 percentage points (Chart 5.6).

Chart 5.7: Full statutory corporate tax rates[a]
OECD-30, 2006

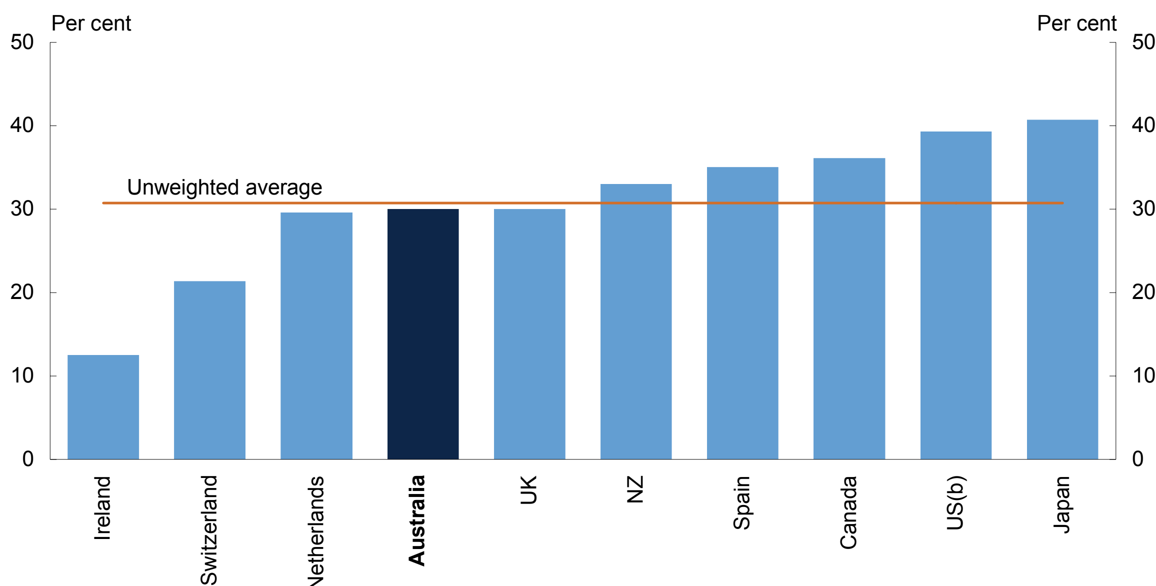


(a) Rates are full (national, sub-national and surcharge) statutory corporate tax rates.
(b) The rate for the United States is the OECD full statutory corporate tax rate for 2005, which is the latest available OECD rate.
Source: OECD Tax Database; KPMG (various); Deloitte (2006); various country websites.

Australia's 30 per cent statutory corporate tax rate is equal eighteenth of the OECD-30 and is slightly above the OECD-30 unweighted average of 28.5 per cent and significantly below the weighted average of 35.6 per cent (Chart 5.7).

Chart 5.8: Full statutory corporate tax rates[(a)]

OECD-10, 2006



(a) Rates are full (national, sub-national and surcharge) statutory corporate tax rates.
(b) The rate for the United States is the OECD full statutory corporate tax rate for 2005, which is the latest available OECD rate.
Source: OECD Tax Database; KPMG (various); Deloitte (2006); various country websites.

Chart 5.8 provides a snapshot of full statutory corporate tax rates for the OECD-10 in 2006. Australia has the equal fourth lowest full statutory corporate tax rate of the OECD-10 countries. The average for the OECD-10 is 30.8 per cent.

5.4.1 Corporate tax rates – detail

Appendix 5.2 provides more detailed information on the corporate tax rate in the OECD-10.

Some of the OECD-10 countries have a lower corporate rate for companies earning relatively small profits or for start-ups. Australia has the entrepreneurs' tax offset which provides an offset of up to 25 per cent of income tax liability on their business income for Simplified Tax System (STS) taxpayers with a group turnover of less than A$75,000.

Spain, which has a general corporate rate of 35 per cent, applies special rates to particular entities:

- listed collective investment including real estate investment funds (1 per cent);
- entities involved in oil and gas research and exploitation operations (40 per cent); and
- asset-holding companies (40 per cent).

Ireland, which has a 12.5 per cent general corporate tax rate, imposes a 25 per cent corporate tax rate on profits from mining, certain petroleum activities and certain land dealing operations.

5.5 CORPORATE TAX BASES

Analysing a country's tax base is as important as analysing its tax rates, although tax base comparisons are much more difficult to quantify.

There are several ways of structuring the corporate income tax base. The conventional or historical approach has been that corporate tax has been imposed on the entire return to corporate equity, that is the normal return as well as any economic profit (above-normal return). All OECD-10 countries use this as the fundamental corporate income tax base.

On the other hand, corporate tax may be levied only on economic profit, making the normal return to capital untaxed (Devereux and Sorensen 2005, p 23). Such a system has been trialled in two countries in the past (but withdrawn). Belgium has just introduced such a system for its income base, and there are features of this approach in the Nordic shareholder model.

Belgium introduced a notional or deemed interest that provides a deduction for the cost of capital. The stated purpose of the Belgium reform is to reduce the tax discrimination between debt financing and equity financing. As a general rule, as the system reduces the corporate income base by allowing deductions for a proportion of the value of equity in the company (based on a long-term government bond rate) or by allowing immediate expensing of capital expenditure, there is a need to have higher corporate tax rates.

Lastly, the corporate tax may be imposed on the entire return to all forms of corporate capital including debt capital. This model was proposed by the United States Treasury in 1992. This 'Comprehensive Business Income Tax' base is much broader than the usual corporate tax base as it establishes equal treatment between debt and equity by not allowing interest deductions. As a result, for any given revenue requirement, this broad base will mean a lower corporate tax rate. No country has introduced such a system.

More details on these alternatives are set out in Appendix 5.1.

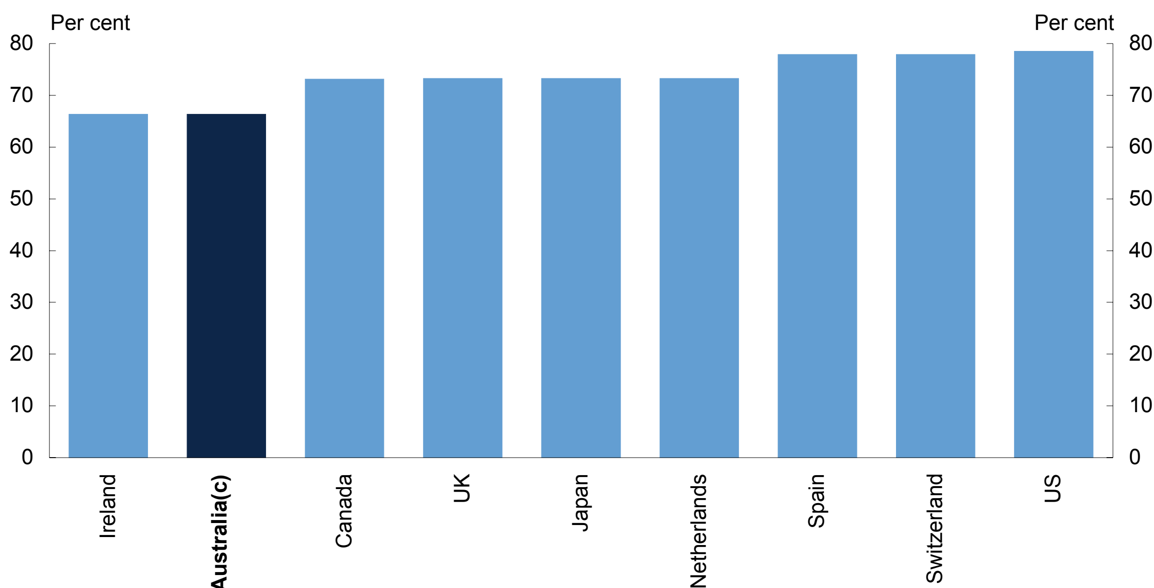
A key element of the corporate tax base is depreciation arrangements. Appendix 5.3 provides detailed information on the depreciation arrangements in the OECD-10.

Depreciation deductions are given in lieu of the loss of economic value of a wasting or depreciable asset. The rate of the deductions given partly reflects the economic life of the asset, the method used to calculate the applicable rate and any other loadings or concessions available.

There are two common methods for determining the rate of write-off for physical assets: prime cost and declining balance. The prime cost (or straight-line) method writes the value of an asset off in equal instalments over its effective life. The declining balance method operates by applying a constant rate of write-off, typically at a higher rate than prime cost, to the written-down value of the asset.

The differing approaches to depreciation result in the value of depreciation deductions varying across countries, as shown in Chart 5.9. Australia has the equal lowest present value of depreciation allowances (around 66 per cent) of the OECD-10 (except New Zealand) measured against the initial purchase price of a hypothetical investment in plant.

Chart 5.9: Present value of depreciation as a proportion of initial purchase price[(a)]
OECD-10[(b)], 2005



(a) The present value figures do not include the value of investment allowances.
(b) Devereux does not do the calculations for New Zealand.
(c) The Devereux estimate for Australia is based on the prime cost method of depreciation. If the declining balance method were adopted the present value of depreciation deductions would be higher, resulting in a marginal improvement in Australia's relative position.
Source: Devereux, Griffith and Klemm (2002); Institute of Fiscal Studies (2006).

There are some similarities in depreciation arrangements applying in the OECD-10 countries, including:

- most countries allow both declining balance and prime cost depreciation;
- rates in many countries are broadly based on the life of an asset; and
- most countries have some form of concessional treatment directed towards particular assets or industries.

Declining balance rates vary across countries. Many countries such as Canada and the United Kingdom use broad asset pools/classifications, with all assets in the pool or within the classification being depreciated at a given rate. Other countries such as Australia, Spain, Switzerland and the United States calculate their declining balance rate with explicit reference to the prime cost rate.

The United States uses double the prime cost rate (so called 'double declining balance') for shorter lived assets and 150 per cent of the prime cost rate for longer lived assets. Switzerland uses a double declining balance method while Spain uses 150 per cent to 250 per cent depending on the life of the asset. Australia's declining balance rate is set at 150 per cent of the prime cost rate for all applicable assets.

It is difficult to make precise comparisons of depreciation arrangements for specific categories of assets because of the varying methods that are used across countries, the investment allowances that some countries provide and the differing methods of recapturing excess depreciation on sale of the asset.

Australia's declining balance rate for an item of plant with an eight-year life is the third lowest out of the OECD-10 countries. For buildings, Australia's rate is around the average of the OECD-10 and for computers Australia's rate is less than average. Australia is one of three countries in the OECD-10 that does not provide amortisation of goodwill.

5.5.1 Treatment of losses

Another key aspect of the corporate tax base is the treatment of losses. Appendix 5.4 provides detailed information on the treatment of losses in the OECD-10.

Half of the OECD-10 permit the carry back of losses: Canada, Ireland, the Netherlands, the United Kingdom and the United States. In the OECD-10 countries, the length of period for loss carry back generally ranges between one and three years while the carry forward period is typically longer, with several countries, including Australia, offering indefinite carry forward.

The OECD-10 countries generally allow the transfer of losses within corporate groups but typically subject to specific restrictions. The OECD-10 countries typically impose restrictions on their loss recoupment rules which are usually variants of either a continuity of ownership test or same business test or both.

5.5.2 Key corporate tax concessions

Countries often offer business a variety of tax concessions although, as was noted earlier, there has been a trend within the OECD-30 towards lowering the statutory corporate tax rate and broadening the tax base by eliminating or reducing corporate tax concessions. Appendix 5.5 provides more information on key corporate tax concessions in the OECD-10.

Most of the OECD-10 countries allow non-capital Research and Development (R&D) expenditures to be expensed, with capital expenditure generally amortised over a defined period. Australia, Canada, Ireland, Japan, Spain, the United Kingdom and the United States provide credits against corporate tax. Ireland's and the United States' credits are available only for incremental Research and Development expenditure. Australia and the United Kingdom are the only countries that provide relief where the Research and Development credit is earned in a loss period.

All of the OECD-10 countries provide specific concessions to particular industries or expenditures, the most common being for mining and minerals exploration and environmental expenditure. Most concessions are provided by way of accelerated depreciation, investment allowances or reduced tax rates. Australia, Spain and the United Kingdom provide some form of accelerated depreciation for small businesses; in the case of Australia and the United Kingdom this is aimed at simplifying the taxation arrangements for these businesses. As noted previously, Canada, Spain, the United Kingdom and the United States have reduced rates for small to medium-sized business.

5.6 EFFECTIVE MARGINAL AND EFFECTIVE AVERAGE TAX RATES — DEFINITIONS AND COMPARISONS

There are a range of other tools for analysing the corporate tax burden and making international comparisons. The use of effective marginal tax rates (EMTRs) and effective average tax rates (EATRs) for the corporate sector has some parallels to the effective rate analysis included in Chapter 4. There are also some significant differences, primarily as most of the analysis for the effective corporate tax burden is based on a time period of several years. This time aspect requires the use of present value analysis to convert future values to today's dollars.

Following is a brief definition and summary of the advantages and disadvantages of effective marginal tax rates and effective average tax rates. Appendix 5.6 (Alternative Measures of the Corporate Tax Burden) provides a more detailed discussion of effective marginal and effective average tax rates.

5.6.1 Effective marginal tax rates

An EMTR is a measure of the effect of tax on the return to a marginal investment. A marginal investment is one that just breaks even or covers all of its economic costs, including a return to the labour and capital that may be provided by the owner of the investment. A marginal investment returns a normal profit to the investor.

The effect of tax on the return to a marginal investment depends not only on the statutory corporate tax rate but also on depreciation allowances and any available corporate tax concessions. In particular, EMTRs are strongly dependent on the value of depreciation allowances, assuming that the corporate base has not been significantly reduced by non-depreciation tax concessions (Devereux, Griffith and Klemm 2002, p 463).

5.6.2 Effective average tax rates

An EATR is a measure of the effect of tax on a non-marginal investment. A non-marginal investment is one that not only covers all of its economic costs but also provides an economic or above-normal profit to the investor. So the EATR is a measure of the proportion of pre-tax economic profit that the investor gets to keep after paying corporate tax.

EATRs may be a better indicator of the tax incentives facing a multinational corporation in deciding on a country for locating a large, discrete investment project, especially where the corporation has a strong expectation that it will earn economic profit due to a patent or similar source of market power.

The advantages of these two measures are summarised in Table 5.1.

Table 5.1: Alternative measures of the corporate tax burden

Method	Advantages	Disadvantages
Effective marginal tax rates	Forward looking measure Measure for incentives to save and invest – and efficiency of tax system Measures the tax burden of a marginal investment Can incorporate taxes at shareholder level Calculates rates for particular taxpayers, groups or industries for various asset types and financing arrangements Long-standing, internationally recognised measure	Complex calculation Not appropriate if project/asset earns above-normal profit
Effective average tax rates	Forward looking measure Measure for examining location decisions for investments Measures the tax burden of an inframarginal investment Can incorporate taxes at shareholder level Calculates rates for particular taxpayers, groups or industries for various asset types and financing arrangements	Complex calculation Problems with determining above-normal profit

These more detailed tools attempt to analyse the effects of the tax system on investment decision-making. While they can incorporate tax issues such as the basic design features of depreciation schemes, these models have difficulty with incorporating the many other differences in more specific design features of corporate tax systems. For instance, different countries have differing depreciation regimes (not just in terms of rates, but in terms of tax base and arrangements for the disposal of depreciated assets). There are often very specific provisions for particular types of investments such as Research and Development, films, venture capital, and small business.

The differences in the results from these models may be narrowed by international tax rules and practice, including the foreign tax credit, thin capitalisation and transfer pricing rules; and the ability of multinational corporations to shift income to low-tax jurisdictions.

At the shareholder level the differing degree of integration of the corporate and personal tax systems across countries affects the tax burden on shareholders. All of these factors contribute to the complexity of making international comparisons of the corporate tax burden.

A balance needs to be struck between capturing the most important characteristics and omitting so many that the comparison becomes so distanced from reality that it is of little practical use. These tools depend critically on the assumptions used in the model but they do have a number of significant advantages over other measures.

5.6.3 Comparisons

Effective marginal tax rates

Devereux, Griffith and Klemm (2002) derive EMTRs for investments in plant and equipment, and industrial buildings financed by either equity or debt. These estimates have been updated and published on the Institute of Fiscal Studies (United Kingdom) website.

In order to calculate the EMTRs a number of assumptions were made by Devereux, Griffith and Klemm:

- the economic depreciation rate for plant and machinery is 12.25 per cent;
- the economic depreciation rate for industrial buildings is 3.61 per cent;
- there is a common fixed inflation rate of 3.5 per cent;
- the real interest rate is 10 per cent; and
- only corporate taxes are included, not personal taxes.

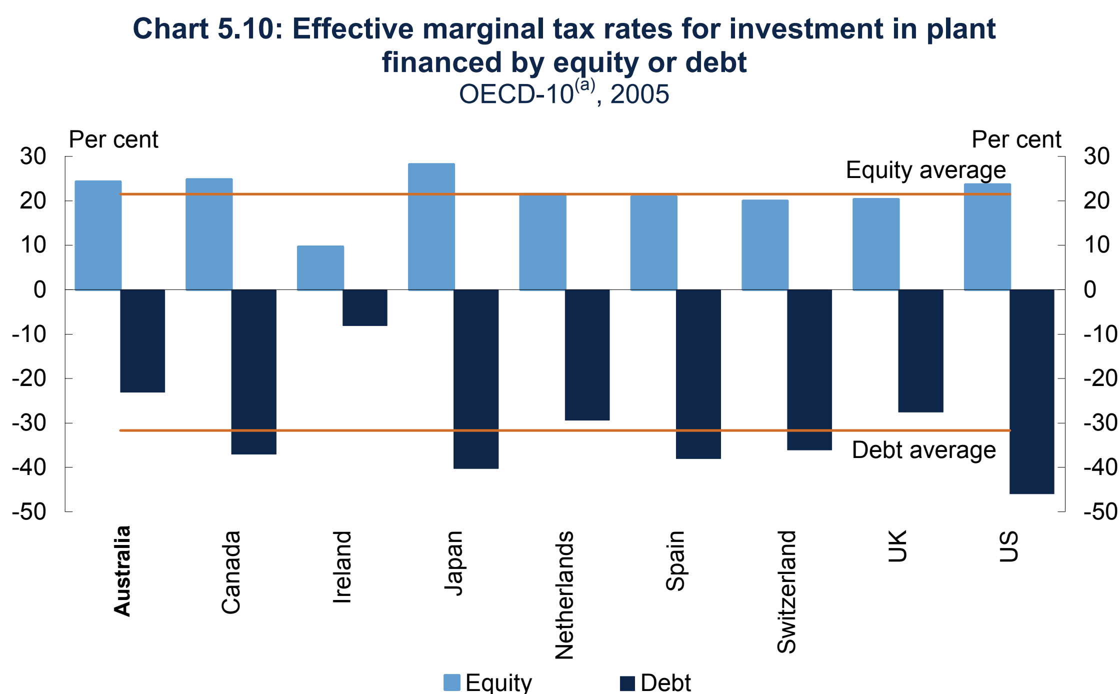
Charts 5.10-5.14 present EMTRs for hypothetical investments for all of the OECD-10 apart from New Zealand as the Devereux calculations do not include New Zealand.

Chart 5.10 shows EMTRs for a marginal investment in plant financed by either equity or debt.

- Australia has the third highest EMTR (24.3 per cent) for a marginal investment in plant financed by equity and is around 3 percentage points above the average EMTR of 21.5 per cent, which Chart 5.11 depicts.
- Australia has the second highest EMTR (-23.1 per cent) for a marginal investment in plant financed by debt and is around 9 percentage points above the average EMTR of -31.7 per cent, which Chart 5.12 depicts.

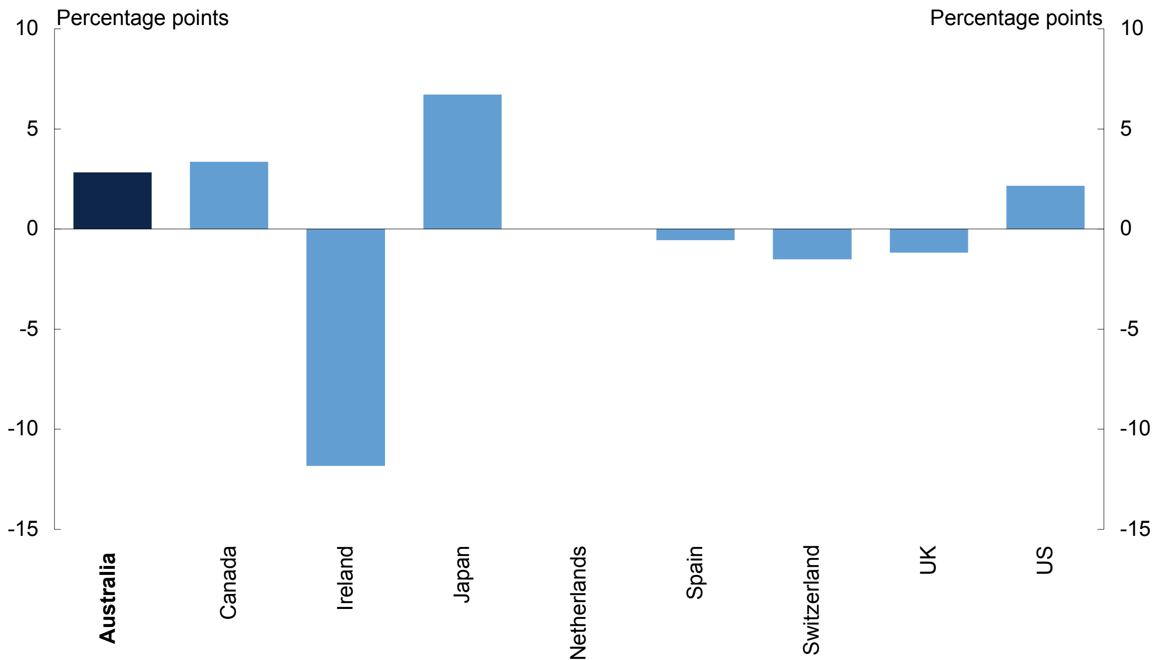
Chart 5.10: Effective marginal tax rates for investment in plant financed by equity or debt

OECD-10[(a)], 2005



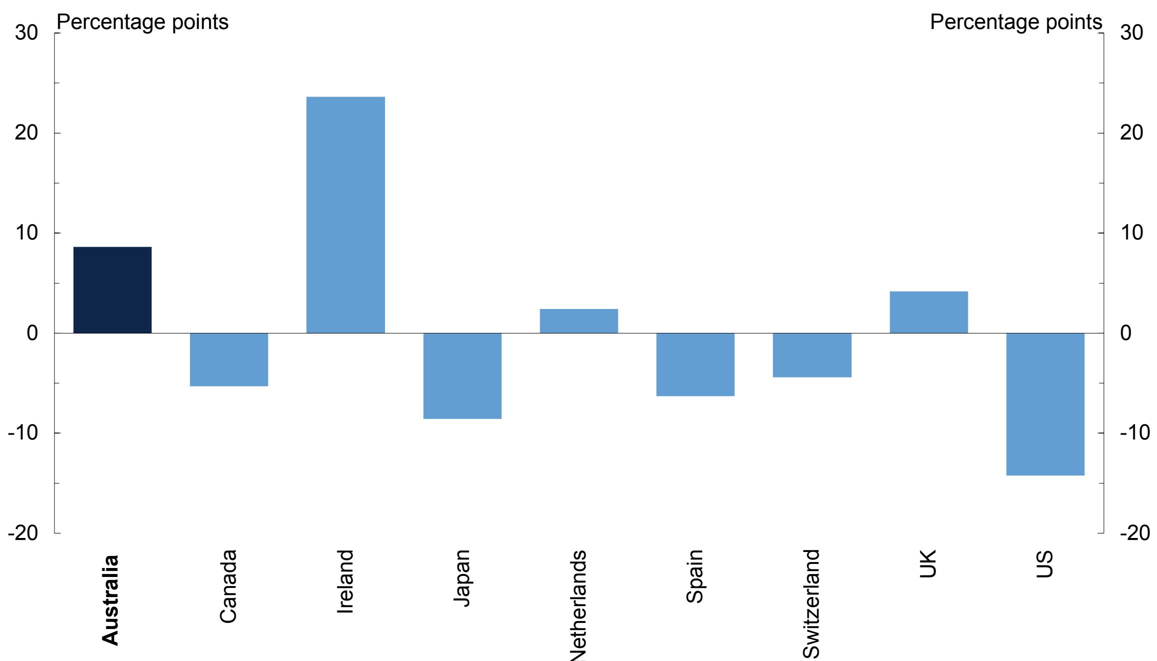
(a) Devereux does not do the calculations for New Zealand.
Source: Devereux, Griffith and Klemm (2002); Institute of Fiscal Studies (2006).

Chart 5.11: Deviation from average EMTR for investment in plant financed by equity
OECD-10[(a)], 2005



(a) Devereux does not do the calculations for New Zealand.
Source: Devereux, Griffith and Klemm (2002); Institute of Fiscal Studies (2006).

Chart 5.12: Deviation from average EMTR for investment in plant financed by debt
OECD-10[(a)], 2005



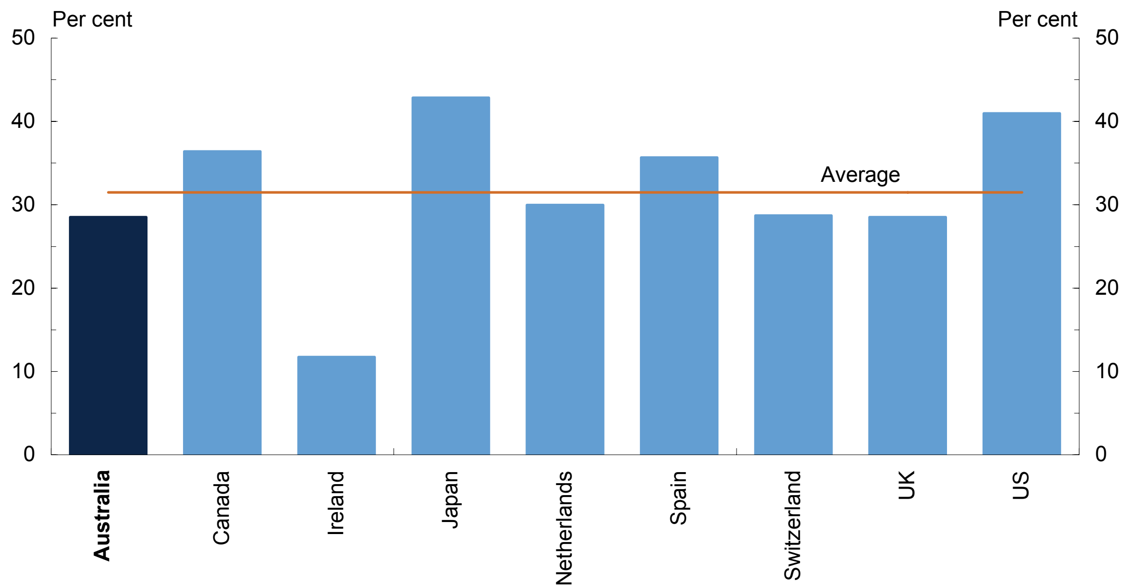
(a) Devereux does not do the calculations for New Zealand.
Source: Devereux, Griffith and Klemm (2002); Institute of Fiscal Studies (2006).

Chart 5.13 shows EMTRs for a marginal investment in industrial buildings financed by equity (Devereux does not do the EMTR calculations for buildings financed by debt).

- Australia has the equal second lowest EMTR (28.5 per cent) for a marginal investment in buildings financed by equity and is 3 percentage points below the average EMTR of 31.5 per cent, which Chart 5.14 depicts.

Chart 5.13: Effective marginal tax rates for investment in industrial buildings financed by equity

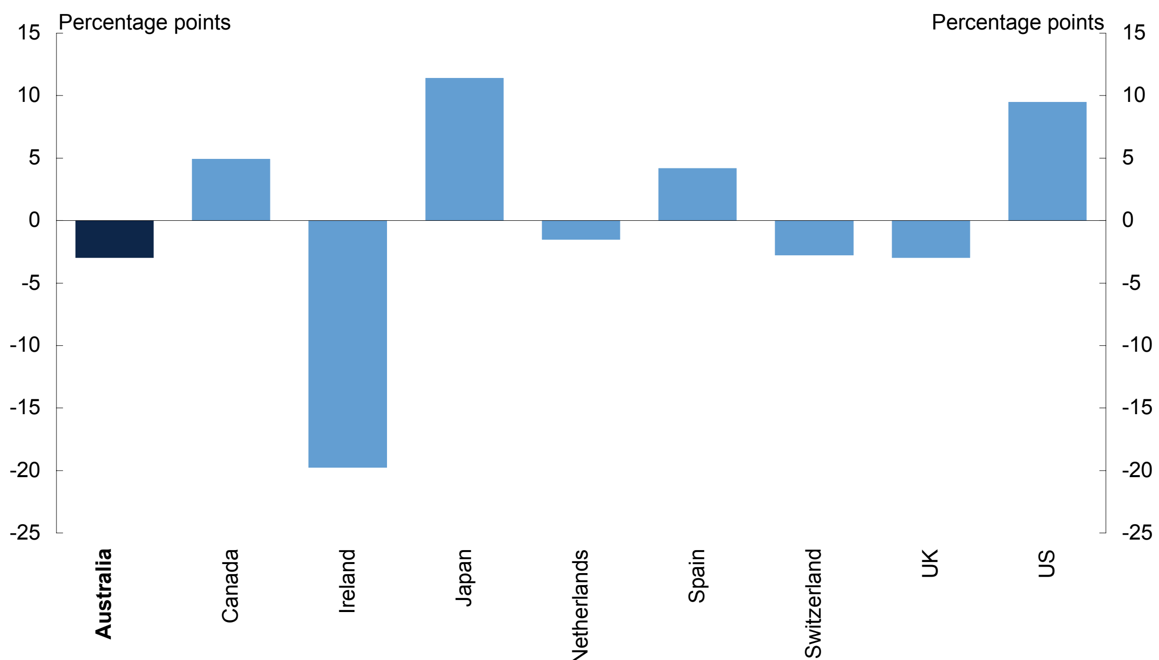
OECD-10[(a)], 2005



(a) Devereux does not do the calculations for New Zealand.
Source: Devereux, Griffith and Klemm (2002); Institute of Fiscal Studies (2006).

Chart 5.14: Deviation from average EMTR for investment in industrial buildings financed by equity

OECD-10[(a)], 2005



(a) Devereux does not do the calculations for New Zealand.
Source: Devereux, Griffith and Klemm (2002); Institute of Fiscal Studies (2006).

Effective average tax rates

Devereux, Griffith and Klemm (2002) also derive EATRs for investments in plant and equipment and industrial buildings financed by either equity or debt (but not debt for buildings) for differing rates of economic profit.

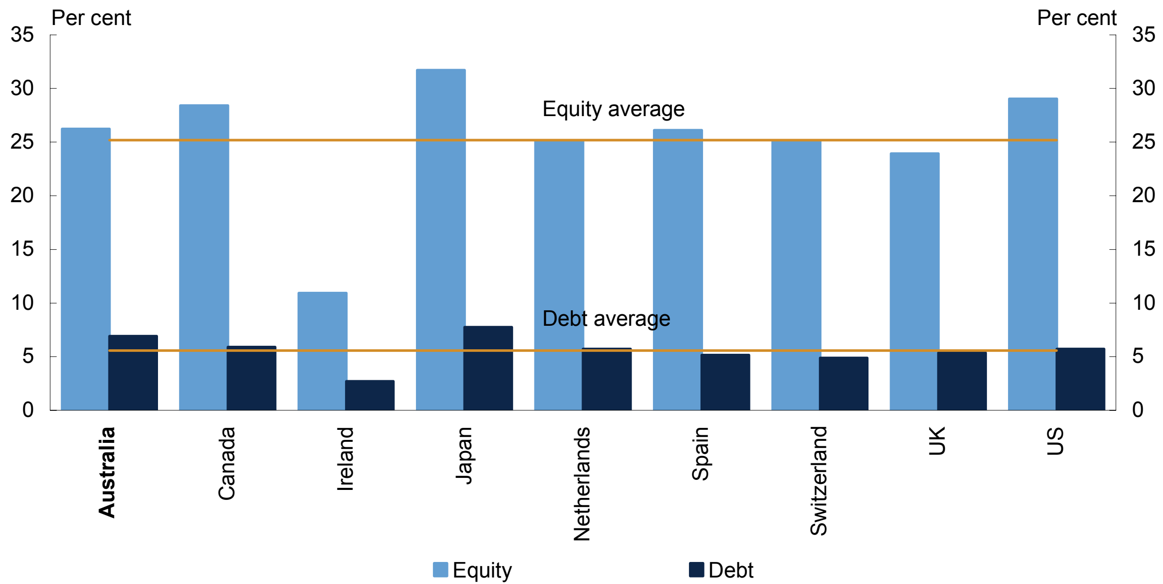
Although the EATR is useful in gaining an understanding of the strategic location decisions of multinational corporations that have an ability to generate economic profits, it is less useful in understanding the behaviour of Australian businesses which raise capital from Australian shareholders and are not choosing between locating in Australia or some overseas country. The EMTR is the better measure for understanding the behaviour of such Australian companies as it offers an explanation of how companies determine their scale of production.

Charts 5.15-5.20 present EATRs and deviations from the average EATR for hypothetical investments for the OECD-10 countries (again excluding New Zealand) in:

- plant and equipment financed by equity or debt with each earning 10 per cent economic profit (the deviation from the average for each type of investment is also charted);
- industrial buildings financed by equity with each earning 10 per cent economic profit (the deviation from the average for each type of investment is also charted); and
- plant and equipment financed by equity earning economic profit of 10 per cent, 20 per cent, 30 per cent and 40 per cent respectively (the deviation from the average EATR is not shown) in these differing level of profit examples.

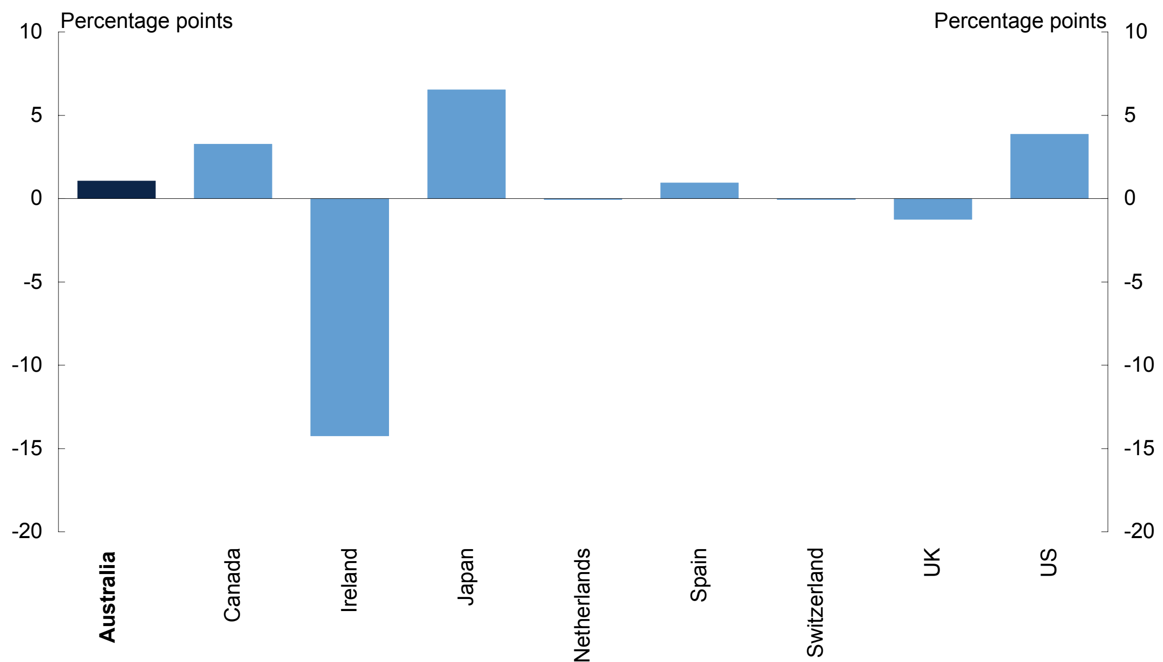
Chart 5.15 shows that Australia has the fourth highest EATR (26.2 per cent) for an investment in plant financed by equity and is around 1 percentage point above the average of 25.2 per cent, which Chart 5.16 depicts; Chart 5.15 shows for a similar investment financed by debt Australia has the second highest EATR (6.9 per cent) and is around 1 percentage point above the average of 5.6 per cent, which Chart 5.17 depicts.

Chart 5.15: Effective average tax rates for investment in plant financed by equity or debt
OECD-10[(a)], 2005



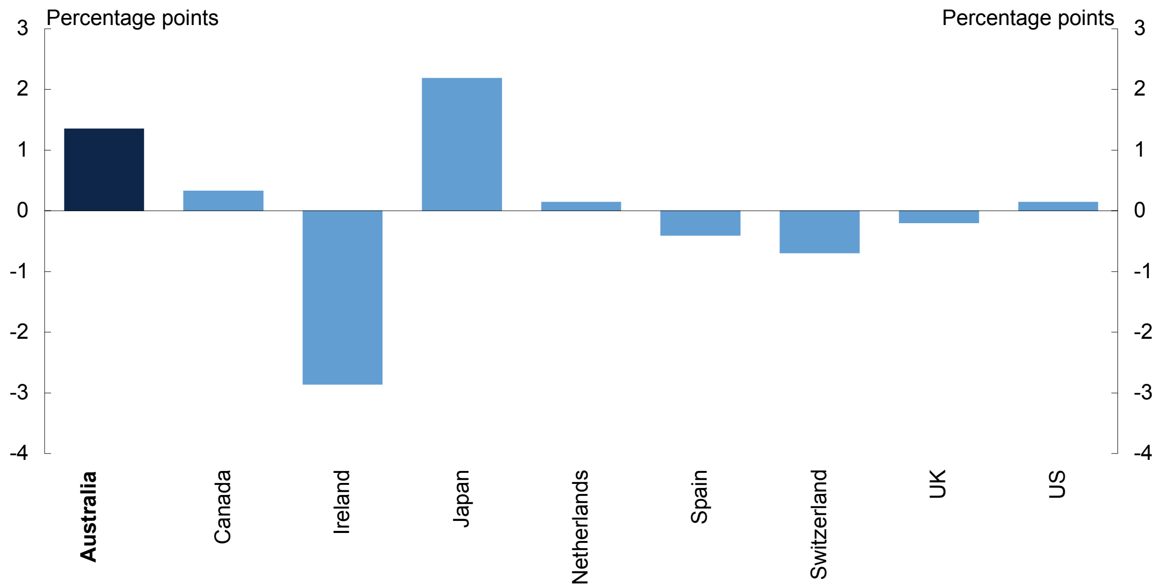
(a) Devereux does not do the calculations for New Zealand.
Source: Devereux, Griffith and Klemm (2002); Institute of Fiscal Studies (2006).

Chart 5.16: Deviation from average EATR for investment in plant financed by equity
OECD-10[(a)], 2005



(a) Devereux does not do the calculations for New Zealand.
Source: Devereux, Griffith and Klemm (2002); Institute of Fiscal Studies (2006).

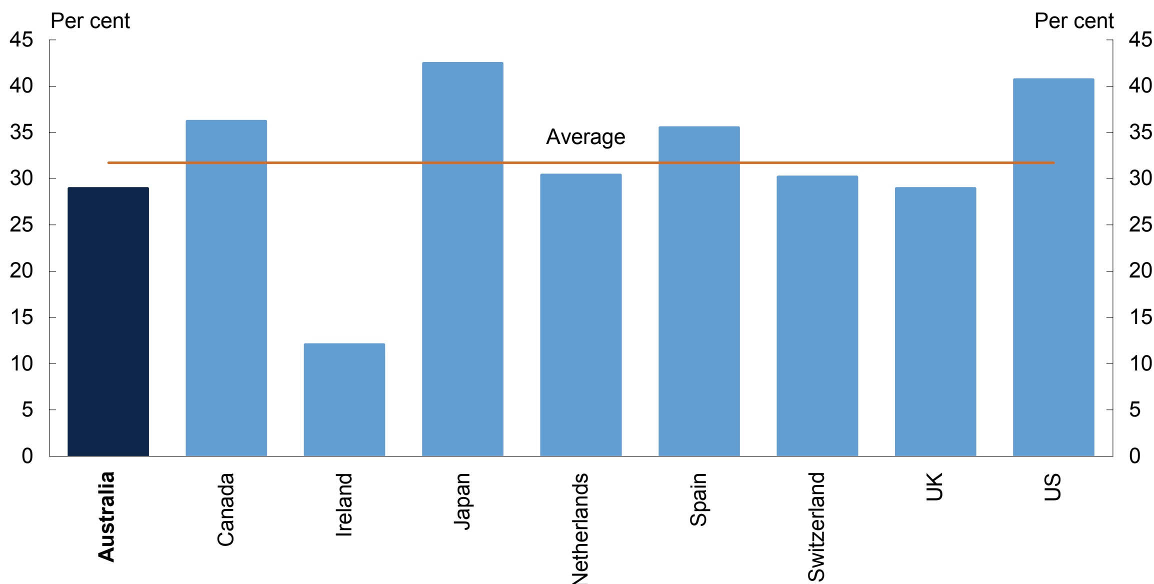
Chart 5.17: Deviation from average EATR for investment in plant financed by debt
OECD-10[(a)], 2005



(a) Devereux does not do the calculations for New Zealand.
Source: Devereux, Griffith and Klemm (2002); Institute of Fiscal Studies (2006).

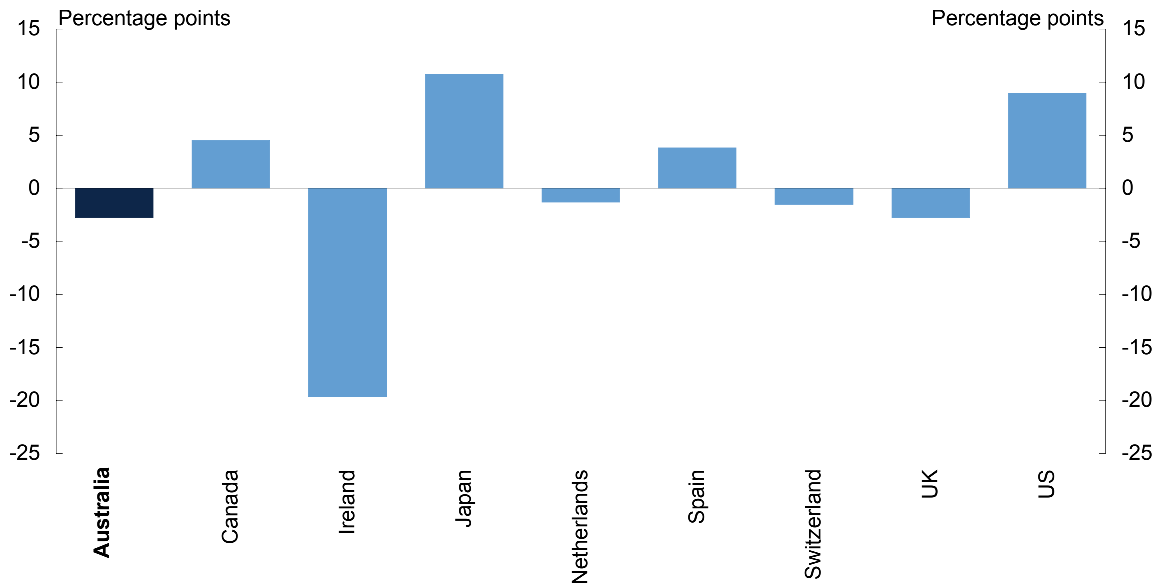
Chart 5.18 shows that Australia has the equal second lowest EATR (29 per cent) for an investment in industrial buildings financed by equity and is around 3 percentage points below the average of 31.7 per cent, which Chart 5.19 depicts.

Chart 5.18: Effective average tax rates for investments in industrial buildings financed by equity
OECD-10[(a)], 2005



(a) Devereux does not do the calculations for New Zealand.
Source: Devereux, Griffith and Klemm (2002); Institute of Fiscal Studies (2006).

Chart 5.19: Deviation from average EATR for investment in industrial buildings financed by equity
OECD-10[a], 2005

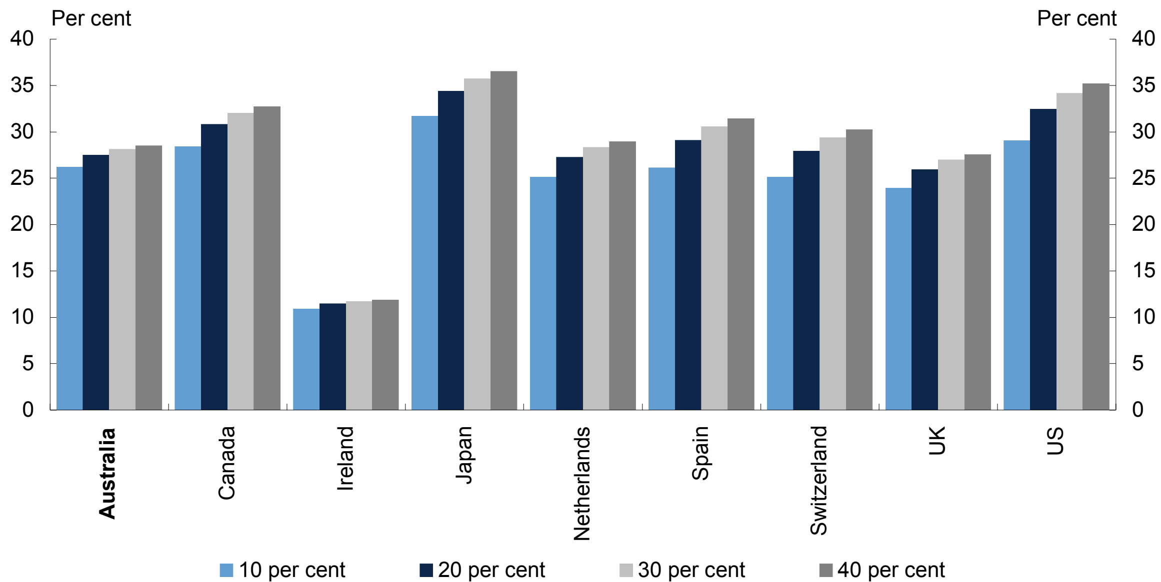


(a) Devereux does not do the calculations for New Zealand.
Source: Devereux, Griffith and Klemm (2002); Institute of Fiscal Studies (2006).

Chart 5.20 shows EATRs for an investment in plant financed by equity for differing levels of economic profit.

- For an investment earning 10 per cent economic profit, Australia's EATR (26.2 per cent) is the fourth highest with the average EATR being 25.2 per cent.
- For an investment earning 20 per cent economic profit, Australia's EATR (27.5 per cent) is the fourth lowest with the average EATR being 27.4 per cent.
- For an investment earning 30 per cent economic profit, Australia's EATR (28.1 per cent) is the third lowest with the average EATR being 28.5 per cent.
- For an investment earning 40 per cent economic profit, Australia's EATR (28.5 per cent) is the third lowest with the average EATR being 29.2 per cent.

Chart 5.20: Effective average tax rates for investments in plant with differing rates of economic profit
OECD-10[(a)], 2005



(a) Devereux does not do the calculations for New Zealand.
Source: Devereux, Griffith and Klemm (2002); Institute of Fiscal Studies (2006).

5.7 Taxation of capital gains

Appendix 5.7 provides detailed information on corporate capital gains taxation in the OECD-10.

With the exception of New Zealand, all of the OECD-10 impose some general form of corporate capital gains tax (CGT). As noted in Chapter 6, although New Zealand does not have a general CGT regime, it has redrawn the boundary between revenue and capital to ensure that particular types of short-term gains are classified as normal operating taxable income (Desai 2006, p 1083).

There are significant variations in the rate of CGT depending on the nature and level of the shareholding. Table 5.2 provides for the OECD-10 the CGT rate applying to a company for the gain made on a sale of: a non-participation shareholding; a resident participation shareholding; and a non-resident participation shareholding. A 'participation' refers to ownership of a subsidiary or affiliate as defined by the particular jurisdiction's law that is eligible for participation relief, typically subject to other conditions being met. There are significant variations in the rate of CGT depending on the nature and level of the shareholding.

Table 5.2: Comparison of corporate capital gains tax rate, OECD-10, 2006

	Company tax rate (per cent)	CGT rate on gain on non-participation (per cent)	CGT rate on gain on resident participation (per cent)	CGT rate on gain on non-resident participation (per cent)
Australia	30.0	30.0	30.0	0.0
Canada(a)	36.1	18.0	18.0	18.0
Ireland	12.5	20.0	0.0	0.0
Japan	40.7	40.7	40.7	40.7
Netherlands	29.6	29.6	0.0	0.0
New Zealand	33.0	0.0	0.0	0.0
Spain	35.0	35.0	0.0	0.0
Switzerland(b)	21.3	21.3	0.0	0.0
United Kingdom	30.0	30.0	0.0	0.0
United States	39.3	39.3	39.3	39.3
Average	30.8	26.4	12.8	9.8

(a) The Canadian rates are based on the general (non-manufacturing) corporate rate.
(b) The rates for Switzerland are based on a capital gain realised by a company in the canton of Zurich.
Source: Various, see Chapter 1 (1.4.1).

Caution needs to be exercised in drawing inferences from Table 5.2, which abstracts from the particular conditions that have to be met for participation relief to be granted. For the gain from the sale of a non-participation, Australia's corporate CGT rate is equal fourth highest and is around 4 percentage points above the average rate (26.4 per cent). For the gain from the sale of a resident participation, Australia's corporate CGT rate is third highest and is around 17 percentage points above the average of 12.8 per cent (Australia's consolidation rules effectively grant resident participation relief for intra-group sales of companies). Australia, like several other OECD-10 countries, exempts the gain from the sale of a non-resident participation provided certain conditions are met.

The canton of Zurich in Switzerland and some other cantons use a stepped-rate system for taxing certain corporate gains where the tax rate at first increases for relatively short holding periods and then decreases as the period of ownership increases.

Some of the OECD-10 countries allow both carry forward and limited carry back of capital losses. Several OECD-10 countries, including Australia, impose restrictive tests on the carry forward of losses.

The OECD-10 provide CGT rollover in specific circumstances that vary from country to country. In addition, Australia provides a range of CGT concessions directed at small business owners (including small corporate businesses) that satisfy the eligibility criteria.

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APPENDIX 5.1: CORPORATE BASE OPTIONS

There are several ways of structuring the corporate income tax base. The conventional or historical approach has been that the corporate tax has been imposed on the entire return to corporate equity, that is, the normal return as well as any economic profit (above-normal return). On the other hand, corporate tax may be imposed on the entire return to all forms of corporate capital including debt capital. Lastly, corporate tax may be levied only on economic rent, making the normal return to capital untaxed (Devereux and Sorensen 2005, p 23).

TAXING THE FULL RETURN TO EQUITY

Most countries around the world, including the OECD-10 countries, subject the entire return to equity to corporate tax which means that they typically allow interest incurred in earning corporate income as a deductible expense. This means that any undistributed profits have been subject to corporate tax.

Countries often start with the competitive capital export neutrality (CEN) principle and seek to tax the worldwide income of their corporations (Hong Kong is an exception as it taxes its corporations only on their domestic source income) but most countries then vary from this principle. For example, many countries (including Australia, the United Kingdom and the United States) do not tax the active or genuine business income of their corporations' direct investments in other countries which is not repatriated. Further, some countries such as Australia provide an exemption for the repatriated income of their corporations' direct offshore investments whereas others, including the United Kingdom, the United States and Japan, operate a foreign tax credit system in relation to their corporations' offshore investments whether they be direct or portfolio.

TAXING THE FULL RETURN TO CAPITAL

Taxing the full return to capital at the corporate level essentially means denying a deduction for interest expenses incurred in the earning of corporate income. In 1992 the United States' Treasury proposed the Comprehensive Business Income Tax (CBIT) as a means of making the corporate investment financing decision neutral between debt and equity. The CBIT proposal was designed to tax corporate income only once and at a uniform rate so as to make the personal taxation of corporate income unnecessary and eliminate the classical double taxation of corporate income (Devereux and Sorensen 2005, p 34). At this stage, no country in the world has adopted the CBIT proposal.

TAXING ECONOMIC RENTS

Other means of making the corporate investment financing decision neutral between debt and equity include introducing a corporate cash flow tax or alternatively an allowance for corporate equity.

Corporate cash flow tax

Introducing a corporate cash flow tax would provide immediate expensing for all capital expenditure. A corporate cash flow tax would effectively tax only economic rents because the present value of the normal return on an investment would equal its capital cost. Some countries such as the United Kingdom and Ireland introduced immediate expensing in the 1970s but then abandoned it.

In recent times Estonia has come close to a corporate cash flow tax. The Estonian distributions tax, if modified to allow a deduction for the corporation's revenue raised from new equity issues, would be effectively the same as the S-based cash flow tax outlined in the report of the Meade Committee in 1978 (Devereux and Sorensen 2005, p 30). However, the EU Parent-Subsidiary Directive, however, may compel Estonia to bring back a traditional corporation tax (Devereux and Sorensen 2005, p 31).

Allowance for corporate equity (ACE)

Another way of only taxing economic rents is to permit corporations to deduct from their corporate tax base an imputed normal return on their equity similar to the interest deduction (Devereux and Sorensen 2005, p 32). From 1994 to early 2001 Croatia ran an ACE system. All firms (corporate and non-corporate) were permitted to reduce their taxable profits by an imputed return on their equity. There was not an obvious reason for Croatia's abolition of the ACE system in January 2001 but the principal objective appears to have been the goal of establishing a reduced headline corporate tax rate (Devereux and Sorensen 2005, p 33).

APPENDIX 5.2: CORPORATE TAX RATES — OECD-10

Appendix table 5.2.1: Corporate tax rates — OECD-10

Country	Top combined corporate tax rate (per cent)	Comment
Australia	30	No sub-national income taxes apply. Certain offshore banking unit (OBU) income (except capital gains) earned by an OBU is taxed at an effective rate of 10 per cent. Income derived from investment companies that are registered pooled development funds is taxed at 15 per cent where the investment is in small to medium enterprises and 25 per cent for other investment income. The entrepreneurs' tax offset provides an offset of up to 25 per cent of income tax liability on their business income for simplified tax system (STS) taxpayers with a group turnover of less than A$75,000.
Canada	36.1	The 36.1 per cent consists of a national rate of 21 per cent, a surtax of 1.1 per cent and a representative sub-national rate of 14 per cent. The rate for Canadian manufacturing and processing income is reduced to 34.1 per cent. The rate for the active business income of a small business company that is less than the threshold of C$300,000 is reduced to 27.6 per cent. The rate for the first C$300,000 of active business income derived by a Canadian-controlled private corporation where the business is carried on primarily in Canada is reduced to 17.6 per cent.
Ireland	12.5	The normal rate of corporate tax is 12.5 per cent. For particular non-trading profits and for profits from mining, certain petroleum activities and certain land-dealing operations the rate is 25 per cent. Dealing in undeveloped residential Irish land is taxed at 20 per cent. A 10 per cent rate is applied to the active trading income of particular current manufacturing companies and to the eligible income of International Financial Services and Shannon companies. The 10 per cent rate for manufacturing is being phased out but still exists for some companies until 2010.
Japan	40.69	The 40.69 rate covers the national corporate tax rate (30 per cent), business, prefectural and municipal taxes. The rate has been calculated using the standard rate for Tokyo including the deduction for business tax. For companies with capital not greater than ¥100 million, the national corporate tax rate is 22 per cent on the first ¥8 million of taxable income and 30 per cent on any excess.
Netherlands	29.6	The corporate income tax rate is 25.5 per cent on the first €22,689 and 29.6 per cent on any balance. The exemptions from corporate income tax include all profits from a forestry business and capital gains, dividends and other profit distributions obtained from an eligible participation. A participation is eligible if the following criteria are all satisfied: (1) the recipient company holds at least a 5 per cent interest in the subsidiary (a percentage of lower than 5 per cent is also eligible if the shares are held for sound business reasons or for the common good); (2) the shares are not stock-in-trade; (3) if the shares are in a non-resident non-EU subsidiary, they may not be a portfolio investment; and (4) if the shares are in a non-resident non-EU subsidiary, the non-resident must be subject to tax on its profits in its home jurisdiction.

Appendix table 5.2.1: Corporate tax rates — OECD-10 (continued)

Country	Top combined corporate tax rate (per cent)	Comment
New Zealand	33	A five-year income tax exemption applies to exploration and development operations in an offshore permit area conducted by a non-resident company. The five-year term begins with the non-resident company's 2005-06 income year and terminates on 31 December 2009.
Spain	35	The general corporate tax rate is 35 per cent. Corporations with yearly net sales not greater than €8 million pay a 30 per cent rate on the first €120,202.41 of annual profits, with any excess taxed at 35 per cent. A surcharge of between 0.01 per cent and 0.75 per cent applies to corporate income tax due and is deductible for corporate income tax purposes. Special rates apply to particular entities: listed collective investment institutions including real estate investment funds (1 per cent); entities involved in oil and gas research and exploitation operations (40 per cent); and asset-holding companies (40 per cent). There is a reduction in the tax base of companies purchasing holdings in non-resident companies that deliver a majority of the voting rights and meet certain other conditions. This concession entails reducing the corporate tax base by the amount of the investments made in the year up to a maximum of €30,050,605.22, providing the reduction does not exceed 25 per cent of the original tax base. The Spanish government has announced that there will be a gradual rate reduction in order to reach 30 per cent by the year 2011. For small and medium-sized companies with a certain limit on their taxable income, the reduction will reach a rate of 25 per cent also by the year 2011.
Switzerland	21.3	The 21.3 per cent is derived from a national rate of 8.5 per cent and a sub-national rate of 17.65 per cent based on a company located in the city of Zurich. The combined rate is not a simple addition of the national and sub-national rates because the taxes are deductible. Cantonal governments may encourage the formation of new companies that are of economic significance by granting them total or partial tax relief. At the national level the State Secretary for Economic Affairs may grant newly established companies tax relief.
United Kingdom	30	Corporate tax rates (£) Up to 10,000 0 10,001 50,000 23.75 50,001 300,000 19 300,001 1,500,000 32.75 Over 1,500,000 30 Note: The unusual structure of the corporate rates results from the clawback of the benefits of the tax free threshold and lower rates as the corporate rate increases. All limits are reduced in circumstances where there are affiliated companies. Small companies in the 0 per cent rate band are taxed at the 19 per cent rate on profits they pay out to non-corporate shareholders. Dividends derived by a resident company from another resident company, which together with the former company satisfies the grouping requirements, are exempt. Non-resident companies pay corporation tax only if they are trading in the United Kingdom via a permanent establishment; otherwise non-resident companies pay income tax at the basic rate of 22 per cent on their United Kingdom-sourced income. For certain types of investment income, such as interest, the 20 per cent savings rate applies. Interest from bank deposits and Euro bonds is not taxable. The United Kingdom government has announced that from April 2006 it will replace the 0 per cent and non-corporate distribution rates of corporation tax for small companies with a single-band rate of 19 per cent.

Appendix table 5.2.1: Corporate tax rates — OECD-10 (continued)

<table>
<tr><th>Country</th><th>Top combined corporate tax rate (per cent)</th><th>Comment</th></tr>
<tr><td>United States</td><td>39.3</td><td>National corporate tax rates (US$)
Up to 50,000 15
50,001 75,000 25
75,001 100,000 34
100,001 335,000 39
335,001 10,000,000 34
10,000,001 15,000,000 35
15,000,001 18,333,333 38
Over 18,333,333 35
The 39.3 rate consists of the national rate of 35 per cent and sub-national rate of 6.6 per cent which is a weighted average sub-national corporate marginal income tax rate. The combined rate is not a simple addition of the national and sub-national average rate because sub-national taxes are deductible at the national level.
Regulated investment companies (RICs) and real estate investment trusts (REITs) are taxed at the corporate rate but can claim a deduction for investment income and capital gains passed out to shareholders.
Corporations that are eligible to be treated as S corporations and elect to do so are treated as fiscally transparent entities. Their income is taxed at the shareholder level only.
Interest derived on bonds issued by United States' sub-national governments is exempt from tax at the national level where the bonds satisfy certain conditions.
The United States has a corporate alternative minimum tax, which aims to ensure that companies making profits pay at least some income tax no matter how many deductions and concessions they claim by requiring them to do another tax calculation that adds back various concessions. There is an exemption from AMT for small corporations.
Note: The unusual structure of the corporate rates results from the clawback of the benefits of the lower rates as the corporate rate increases.</td></tr>
</table>

Source: Various, see Chapter 1 (1.4.1).

APPENDIX 5.3: DEPRECIATION ARRANGEMENTS — OECD-10

Appendix table 5.3.1: Depreciation arrangements — OECD-10

Country	Prime cost or declining balance method	Determination of rate	Switching	Loadings	Balancing charge offset	Industry specific arrangements
Australia	Generally can choose either prime cost or declining balance method. Declining balance rates are 150 per cent of prime cost rates. For buildings and certain intangible assets, prime cost must be used.	Rate depends on the effective life of the asset. The taxpayer may choose to use either a reasonable estimate of the effective life or the effective life determined by the tax authorities. Intangible assets must use the effective life prescribed by the tax authorities. Depreciation rate is determined using the following formulas: • Prime cost method: 100 per cent divided by asset's effective life. • Declining balance method: 150 per cent divided by asset's effective life.	No	None	Only applies to balancing adjustment events occurring before 21 September 1999, unless the taxpayer is a small business taxpayer for the income year in which the balancing adjustment event occurred.	Some relief for small businesses under the Simplified Tax System (STS). Adjustment to prescribed effective lives for the oil and gas pipeline, transmission and distribution industry; the aviation industry; and the motor transport and truck assets industry. Taxpayers can claim deductions for the loss in value of depreciating assets costing less than A$1,000 via a low-value pool. This option is also available where the declining balance method is used and the asset's written-down value is less than A$1,000.
Canada	Generally calculated on a declining balance basis at prescribed rates.	Rate is generally provided by regulations. The declining balance depreciation rates for plant and equipment are 20 to 30 per cent, while the depreciation rate for buildings is 4 per cent.	No	None	Generally no charge due to the extensive use of pooling.	Generally no.

Appendix table 5.3.1: Depreciation arrangements — OECD-10 (continued)

Country	Prime cost or declining balance method	Determination of rate	Switching	Loadings	Balancing charge offset	Industry specific arrangements
Ireland	Prime cost. Declining balance used for some motor vehicles.	Prescribed rate.	No	Approved expenditure on buildings for pollution control costing. Sea fishing boats.	Taxpayer can reduce the cost of a replacement item by any balancing charge arising on the disposal of the original item.	100 per cent write-off for capital expenditure on oil and gas exploration, development and abandonment, incurred under a licence issued by the Minister for Energy. Urban renewal schemes including 50 per cent write-off for commercial and industrial buildings. Special rules for certain telecommunication infrastructure. 100 per cent capital allowance for child care facilities. Various other special rules including mining, ships, private health, and agricultural buildings.
Japan	Generally can choose either prime cost or declining balance method. Buildings must be depreciated using the straight-line method and intangible assets must also generally be amortised using this method.	Taxpayers cannot apply their own depreciation rates and must use those stipulated by Japanese tax law, which provides a range of rates for each asset category based on the useful life. Depreciation for tax purposes may not exceed the amount of depreciation recorded for accounting purposes.	In general, the depreciation method selected by the corporation must be applied consistently. The corporation may apply to change the method. The application must be submitted to the tax office prior to the commencement date of the accounting period in which the change is to be effected.	In the year when specified machinery or equipment is acquired, a corporation may take additional depreciation. With respect to certain fixed assets, a corporation has the option of taking such additional depreciation or claiming the investment tax credit (see Appendix 5.5).	Capital gains/losses on sale of equipment must be included in computation of taxable income for the year during which the equipment is sold. Taxation on income realised from certain assets can be deferred by reducing the value of newly acquired fixed assets by the amount of that income, with a number of required conditions.	Special depreciation, by means of either additional depreciation for the first year or accelerated depreciation, is available for corporations filing blue form tax returns in relation to certain fixed assets as specified under the tax law. Examples include: • *Qualifying facilities for preventing pollution:* 10 to 14 per cent of acquisition cost (75 per cent of the acquisition cost in the case of a large corporation). • *Qualifying ships for sea transportations:* 16 to 18 per cent of acquisition cost.

Appendix table 5.3.1: Depreciation arrangements — OECD-10 (continued)

Country	Prime cost or declining balance method	Determination of rate	Switching	Loadings	Balancing charge offset	Industry specific arrangements
Japan (continued)						‘Blue tax return’ filing status allows companies several tax privileges including the ability to carry forward tax losses and to use accelerated depreciation rates for certain assets. To qualify for and maintain a blue return filing status, a taxpayer must maintain ‘clean’ accounting books in Japan (that is, accounts prepared in accordance with Japanese accounting standards with no issues/subsequent adjustments); produce accounts quickly for tax auditors; and file tax returns within time limits.
Netherlands	Prime cost (declining method may be allowed in exceptional cases). Assets should not be depreciated below a residual value.	Depreciation rate is in accordance with the expected economic life and residual value. The law does not contain a specific rate or period.	Switching is allowed only if this switch is not aimed at a one time tax benefit and is in line with the ‘sound business practice’ principle.	For certain assets free depreciation is available, the amount of which is generally limited to the acquisition or production cost. Four types of assets are eligible for free depreciation: assets important for protection of the environment; assets important for improving working conditions; assets that are of technological importance or are used for Research and Development (R&D); and assets used for production in certain regions or by certain groups of companies.	*Reinvestment reserve:* Deferral for three years for gains from certain business assets (if being replaced by similar assets) which is then offset by the purchase price of the new assets, thereby reducing allowable depreciation.	Accelerated depreciation is available for environmentally friendly fixed assets and sea-going vessels. Assets with a minor value can be written off immediately as a current expense in the year of acquisition.

Appendix table 5.3.1: Depreciation arrangements — OECD-10 (continued)

Country	Prime cost or declining balance method	Determination of rate	Switching	Loadings	Balancing charge offset	Industry specific arrangements
New Zealand	Generally can choose either prime cost or declining balance method.	The estimated useful life of an asset is determined by the Inland Revenue and the rate for that asset is the function of a pre-set formula, incorporating the estimated useful life. Inland Revenue publishes the straight-line and declining balance method rates and these must be used. A Bill before Parliament provides for a new pre-set formula for calculating deprecation rates, referred to as the double declining balance method. Taxpayers can apply to the Commissioner to determine a special depreciation rate.	Yes (unless pool method of deprecation is adopted, in which case this has to be maintained for all assets in the pool).	20 per cent loading applies to all new assets, excluding buildings, used imported motor cars and international aircraft. 20 per cent loading will continue to apply once double declining balance method is adopted.	Recapture and further deduction upon sale of an asset (except for buildings) but no offsets allowed.	Special deductions exist for specific industries including mining, forestry, agriculture and petroleum. Accelerated depreciation for all assets other than buildings, aircraft. Mineral mining exploration and development costs are 100 per cent deductible plus a deduction is available for income appropriated for planned expenditure within the next two years. Forestry planting and maintenance expenditure are immediately deductible. Cost of standing timber deductible only at sale. Scientific research expenditure immediately deductible. International aircraft depreciable at 15 per cent declining balance method or 10 per cent straight-line. Film expenditure, including depreciation, deductible over two years spanning film completion. Straight-line depreciation deduction for fixed life intangible property. Assets of value less than NZ$2,000 can be pooled and depreciated using lowest declining balance rate applying to any pool asset. Small asset write-off of NZ$500.

Appendix table 5.3.1: Depreciation arrangements — OECD-10 (continued)

Country	Prime cost or declining balance method	Determination of rate	Switching	Loadings	Balancing charge offset	Industry specific arrangements
Spain	Prime cost method may be used for any depreciable asset. Declining balance method may be used for certain new tangible assets that have an anticipated useful life of three years or more (only new assets located in Spain qualify for declining balance). Sum of digits. Declining balance and sum of digits may not be applied to buildings, furniture and tools.	Fixed by law, rates vary depending on the industry. Companies may use higher rates if they can demonstrate that the actual depreciation is in excess of that allowed by law. Under a temporary measure, depreciation rates may be increased by 10 per cent for new assets acquired between 1 January 2003 and 31 December 2004. The declining balance rates are determined by reference to the applicable straight-line rate, weighted by the following coefficients: • less than five years: one and a half; • five years or more but less than eight years: two (double declining balance); and • eight years or more: two and a half.	Allowed only in very exceptional cases.	Smaller companies can claim: • free depreciation (a type of investment allowance) for investments in new tangible fixed assets that create jobs; • calculated by multiplying the amount of increased employees by Ptas15 million (€90,151); and • investment in new small-value tangible assets to a maximum claim of Ptas two million (€12,020). Accelerated depreciation for new tangible and intangible assets at one and half times the straight-line depreciation rate.	No. A tax credit exists.	Specific arrangements apply to hydrocarbon and mines concessions while small business has access to accelerated depreciation rates.
Switzerland	Generally can choose either prime cost or declining balance method. Rates for declining balance method are double those under the straight-line method — 'double declining' balance.	Maximum safe haven rates set out in official federal guidelines. If taxpayer can prove that higher rate is justified, then such rate may be used. Some cantons have special favourable rates, including immediate expensing.	Switching is basically not allowed. Exemptions may be accepted if the system of the whole enterprise is changed.	Water pollution abatement machinery and installations.	There is a charge offset with regard to essential operational assets at the national and cantonal level.	There are no industry-specific enhanced depreciation/amortisation rules, but investments for energy-saving equipments and environmentally-friendly machineries can be depreciated preferentially.

Appendix table 5.3.1: Depreciation arrangements — OECD-10 (continued)

Country	Prime cost or declining balance method	Determination of rate	Switching	Loadings	Balancing charge offset	Industry specific arrangements
United Kingdom	The declining balance method applies to capital allowances (tax depreciation) on plant and equipment. The straight-line method applies to industrial buildings and goodwill (see Appendix table 5.3.2). Non-industrial commercial buildings such as offices qualify for tax depreciation only if they are located in Enterprise Zones.	Rates prescribed for asset classes. Generally the depreciation rates for plant and equipment are 25 per cent and 4 per cent for buildings.	No	First-year allowances are available for expenditure on plant and machinery incurred by small and medium-sized enterprises at a rate of 40 per cent; expenditure on water-efficient technology assets after 31 March 2003 at a rate of 100 per cent; certain expenditure on energy-saving plant and machinery at a rate of 100 per cent; and expenditure on industrial buildings in qualifying enterprise zones at a rate of 100 per cent. Not for capital expenditure, although accelerated tax depreciation rates are prescribed in some circumstances. (Separately, loadings apply to qualifying revenue-type expenditure on Research and Development — see Appendix 5.5).	Pooling for general plant and equipment results in allowances being given on the net amount each year (subject to first-year allowances). In other circumstances capital allowances previously claimed are clawed back when a qualifying asset is sold at above its original cost.	See Appendix table 5.3.2.

Appendix table 5.3.1: Depreciation arrangements — OECD-10 (continued)

Country	Prime cost or declining balance method	Determination of rate	Switching	Loadings	Balancing charge offset	Industry specific arrangements
United States	Generally double declining balance for shorter lived assets, and 150 per cent declining balance for longer lived assets. Straight-line for real property (see note). Salvage value is always deemed to be nil. Note: Assets are grouped into classes and each class is assigned a recovery period and a depreciation method. Various exceptions also exist that can result in longer depreciation periods or less accelerated depreciation methods.	The Internal Revenue Service has published guidance listing the required 'class life' for various asset classes. The class life determines the allowable recovery period and depreciation method. Taxpayers can also elect to use certain allowable longer depreciation periods or allowable less accelerated depreciation methods.	Once the depreciation method and life are selected in a filed tax return, a change is generally not allowed (although, as noted below, there is an automatic switch to straight-line from declining balance). Note: The declining balance methods generally switches to straight-line over the remaining depreciable life when that results in a greater annual depreciation amount than the declining balance method, so that the full cost is depreciated by the end of the depreciable period.	None	Gain/loss is computed based on the difference between the selling price and the cost base of the item sold reduced by depreciation deductions taken against that item. Such gain/loss is included in taxable income. Under certain circumstances, gains from the sale of assets used in a trade or business can be treated as capital gains rather than ordinary income, but generally the amount of gain that is treated as capital gain is reduced by the amount of depreciation previously claimed (commonly referred to as 'depreciation recapture'). Different 'recapture' provisions apply to real property. Other than in a qualifying 'like-kind exchange' transaction, profit on sale of equipment cannot be offset against replacements or other equipment to defer the tax gain.	The cost of certain depreciable personal property up to US$100,000 can be expensed in the year acquired, if certain limitations are met; for example the US$100,000 amount is reduced dollar-for-dollar by the total amount of qualifying property placed in service in that year that exceeds US$400,000. Note: Under current law, the US$100,000 and US$400,000 amounts will reduce to US$25,000 and US$200,000, respectively, for tax years beginning after 2007.

Appendix table 5.3.2: Summary of annual depreciation rates (selected assets) — OECD-10

Country	Equipment (approximately eight-year life)	Buildings	Computers	Intangibles
Australia	Effective life for equipment as determined by the ATO mostly higher than eight years. Prime cost: 12.5 per cent. Declining balance: 18.75 per cent.	2.5 per cent or 4 per cent of original cost of building.	Generally, over four years. Prime cost: 25 per cent. Declining balance: 37.50 per cent.	Non-deductible. Blackhole provisions provide five years write-off for expenditure on rights that preserve the value of goodwill. Other business expenditure that preserves the value of goodwill may be deductible.
Canada	20 per cent declining balance.	4 per cent of purchase price.	30 per cent.	7 per cent (declining balance rate) allowable for 75 per cent of cost with respect to purchased goodwill only.
Ireland	12.5 per cent of original cost over eight years.	4 per cent of original cost over 25 years. See Appendix table 5.3.1 with regard to industry-specific arrangements for details of accelerated annual depreciation rates.	12.5 per cent of original cost over eight years.	Non-deductible.
Japan	12.5 per cent straight-line. 25 per cent declining balance.	Maximum of 14.2 per cent and minimum of 2 per cent for straight-line only.	25 per cent straight-line. 43.8 per cent declining balance.	Amortised using the straight-line method over a period of five years.
Netherlands	12.5 per cent prime cost.	2.5 to 4 per cent. Possibly not allowed as of 2007.	33 to 50 per cent.	Self-developed goodwill cannot be activated, so cannot be depreciated; acquired goodwill through asset deal amortisable over 5-10 years depending on the underlying assets.
New Zealand	Prime cost: 18.6 per cent (including 20 per cent loading). Declining balance: 26.4 (including 20 per cent loading). Note: The New Zealand government introduced legislation in May 2005, with a date of effect of 1 April 2005, to move to a double declining balance method.	3 per cent — straight-line. 4 per cent — declining balance.	36 per cent — straight-line (including 20 per cent loading). 48 per cent — declining balance (including 20 per cent loading).	Acquisition payment non-deductible. Preservation cost deductible.
Spain	Maximum of 10 per cent or 15 per cent for office equipment, depreciated over a maximum of 20 or 14 years respectively.	Maximum of 2 per cent for commercial buildings, depreciated over a maximum of 100 years. Maximum of 3 per cent for industrial buildings, depreciated over a maximum of 68 years.	Maximum of 25 per cent, depreciated over a maximum of eight years.	Under certain circumstances, goodwill acquired from non-related parties and through consideration is depreciable for tax purposes. Maximum of 5 per cent, depreciated over a maximum of 20 years.

Appendix table 5.3.2: Summary of annual depreciation rates (selected assets) — OECD-10 (continued)

Country	Equipment (approximately eight-year life)	Buildings	Computers	Intangibles
Switzerland	**Machinery for production purposes:** Straight-line — 15 per cent. Declining balance — 30 per cent.	**Commercial buildings:** Straight-line — 1.5 to 2 per cent. Declining balance — 3 to 4 per cent. **Industrial buildings:** Straight-line — 3.5 to 4 per cent. Declining balance 7 to 8 per cent.	**Office machines:** Straight-line — 20 per cent. Declining balance — 40 per cent.	**Goodwill:** Straight-line — 20 per cent. Declining balance — 40 per cent.
United Kingdom	25 per cent a year on reducing balance method (6 per cent a year on a reducing balance method where the useful economic life when new is more than 25 years). First-year allowances of 40 per cent are available for certain investments by small and medium-sized businesses. The rate of first-year capital allowances for small business spending on most plant and machinery will be increased from 40 per cent to 50 per cent for a period of one year for spending incurred on or after 1 April 2006 by businesses subject to corporation tax, and on or after 6 April 2006 by businesses subject to income tax. First-year allowances of 100 per cent are available for particular investments including in certain energy-saving plant and equipment, water efficient and for qualifying capital expenditure on Research and Development.	4 per cent straight-line based on original cost for qualifying industrial buildings. Different rules apply to the second and subsequent owners. Separate rules apply where buildings are located in enterprise zones.	Until 31 March 2004 small businesses were able to claim 100 per cent of their qualifying ICT expenditure in the year of investment. Currently, ICT assets can (by election) form a single asset pool for capital allowances purposes as short-life assets (where they are likely to have a lifetime of less than five years).	Following the *Finance Act 2002* tax deductions are available in respect of purchased goodwill broadly in line with the accounting amortisation. Where there is no accounting amortisation a separate tax election for tax depreciation at 4 per cent per annum is available. This applies to goodwill purchased by means of a trade and assets purchase, not a share acquisition or internally generated goodwill.

Appendix table 5.3.2: Summary of annual depreciation rates (selected assets) — OECD-10 (continued)

Country	Equipment (approximately eight-year life)	Buildings	Computers	Intangibles
United States	Generally depreciated over a five-year period utilising a double declining balance rate for property, switching to straight-line over the remaining depreciable life when that results in a greater annual depreciation amount than the double declining balance method. The taxpayer, however, may choose an allowable alternative method and a prescribed longer depreciation period. Note: Most equipment would have a class life of ten to fifteen years, which would result in a seven-year period utilising a double declining balance rate, again switching to straight-line over the remaining depreciable life when that results in a greater annual depreciation amount than the double declining balance method (see note). Note: Unless an exception applies, depreciable personal property is generally considered to be placed in service in the middle of the tax year (the 'mid-year convention'), so depreciation deductions are actually claimed, for example, in eight taxable years. A similar 'mid-month convention' applies to depreciable real property.	Residential rental buildings usually depreciated over 27.5 years, other buildings usually depreciated over a 39-year (see note) recovery period, in both cases using straight-line. Note: recovery period is 31.5 years if placed in service before 13 May 1993.	Generally depreciated over a five-year period utilising a double declining balance rate for property, switching to straight-line over the remaining depreciable life when that results in a greater annual depreciation amount than the double declining balance method. The taxpayer, however, may choose alternative methods.	Subject to certain restrictions, purchased goodwill may be amortised over fifteen years on a straight-line basis.

Source: Various, see Chapter 1 (1.4.1).

APPENDIX 5.4: TREATMENT OF LOSSES — OECD-10

Appendix table 5.4.1: Treatment of losses — OECD-10

Country	Treatment of tax losses	Transfer (including conditions)
Australia	Carry forward indefinitely, subject to the 'continuity of ownership' test or (for companies with a turnover of less than A$100 million) the 'same business' test applies. No carry back.	Only available for consolidated groups.
Canada	Losses may be carried back, usually three years, subject to limitations. Losses may be carried forward for 10 years if carrying on same business with a view to profit.	There is no method of setting off losses of one corporation within a group of controlled companies against profits of another.
Ireland	Trading losses can be utilised in current year on a value basis. Carry forward of trading losses until change of ownership or business. Carry forward not allowed if there is a change of business or if the volume of trade has become negligible and subsequently becomes profitable. Manufacturing losses, carry forward only against 10 per cent income in each subsequent year. Carry back of trading losses against profits before charges, with limit applied according to proportion of income (for example 10 per cent loss in year two offsets up to 10 per cent income in year one). Terminal loss relief — a loss incurred in the final year of trading can be carried back against income from the same trade in the three years preceding those last 12 months.	Yes, for common ownership of at least 75 per cent.
Japan	Carry forward for seven years for: • a corporation filing a blue form tax return; and • losses stemming from inventory, fixed assets or certain deferred assets caused by natural disaster without filing a blue form tax return. Carry back for one year. The carry back was suspended for fiscal years ending from 1 April 1992 through to 31 March 2006 (note that the suspension is expected to extend through to 31 March 2008 under the draft 2006 Tax Reform), except for certain small and medium-sized companies and those in liquidation.	Generally, net operating losses are not transferable between group companies unless they are part of a tax consolidated group.

Appendix table 5.4.1: Treatment of losses — OECD-10 (continued)

Country	Treatment of tax losses	Transfer (including conditions)
Netherlands	Carry forward indefinitely with special rules for holding companies. Carry back for three years. (Please note carry forward most probably limited in time (eight years) as of 2007.)	Yes, within consolidated group (fiscal unity). The conditions for fiscal unity include that: • the parent company owns at least 95 per cent of the beneficial and legal ownership of the shares in the subsidiary; • the taxpayers have matching financial years; • the taxpayers are subject to the same tax regime; and • both taxpayers have their tax residence in the Netherlands.
New Zealand	Trading losses may be carried forward indefinitely, subject to continuity of ownership. A 'continuity of ownership' test of 49 per cent (based on aggregate minimum voting interest) is applied in order for losses to be carried forward. No carry back allowed.	Where common ownership is 66 per cent or more, losses may be offset against other group company profits either by election or subvention. No requirement to be a member of a consolidated group.
Spain	Carry forward for 15 tax years. For newly established enterprises, the 15-year period begins in their first profitable year for tax purposes. If there is a change in ownership then a restriction on the carry forward of losses applies in particular circumstances, mainly where the company has not had activity in the previous six months. No distinction between ordinary and capital losses. No carry back.	Yes, for consolidated groups (75 per cent ownership).
Switzerland	For national tax purposes, tax losses can be carried forward by seven years. No carry back is allowed. The carry-forward period varies among the cantons but it is generally seven years. Losses incurred by a foreign permanent establishment are deductible from taxable income. Still if a foreign permanent establishment of a Swiss company realises profits in the seven years following the year of a loss and if the permanent establishment can offset the loss against such profits in the foreign jurisdiction, the Swiss company must add the amount of losses offset in the country of the permanent establishment to its Swiss taxable income.	Tax losses of previous years can be transferred to the acquiring company in the course of a reorganisation under the Swiss Merger Act as long as the following conditions are met: • the acquiring company remains liable to the Swiss tax regime; and • there is no tax avoidance.
United Kingdom	Trading losses can be set against the other profits and capital gains of the company for the same accounting period. Trading losses can be carried forward indefinitely against future profits arising from the same trade. Trading losses can be carried back for one year and set against the profits and capital gains of the company for the previous accounting period. Trading losses being carried forward can become extinguished where there is a change in the ownership of the company and within a period of three years there is also a major change in the nature or conduct of a trade.	Trading losses can be surrendered by United Kingdom resident companies who are within the same corporate group or consortium for the same accounting period. Following the European Court of Justice case of Marks and Spencer v Halsey, it may be possible in limited circumstances for trading losses generated by a company tax resident in another European Union member state to be surrendered to a United Kingdom resident company within the same corporate group. The final outcome of this case requires ratification in the United Kingdom courts.

Appendix table 5.4.1: Treatment of losses — OECD-10 (continued)

Country	Treatment of tax losses	Transfer (including conditions)
United States	In general, losses can be carried back two years and forward 20 years to offset taxable income in those years. Continuity of majority ownership must be satisfied; otherwise the amount of losses that can be utilised in a given tax year is subject to an annual limitation. In most cases, there is no requirement for continuity of business enterprise.	For a corporate group filing a consolidated United States federal income tax return, the group's taxable income is calculated across the entire group, effectively netting losses against the income of other group members. Note that the United States does not allow 'multiple entry consolidations'; the ultimate parent of a group filing a consolidated United States federal income tax return must be a United States' corporation, and 80 per cent or more of the shares of includible United States' subsidiaries must be owned by United States' corporations included in the group.

Source: Various, see Chapter 1 (1.4.1).

APPENDIX 5.5: CORPORATE TAX CONCESSIONS

Appendix table 5.5.1: Corporate tax concessions

Country	Research and Development (R&D)	Others
Australia	If the annual amount of expenditure on R&D exceeds A$20,000, expenditure deductible at the rate of 125 per cent. 125 per cent of the normal write-off rate for qualifying plants for R&D activities may be claimed if the R&D expenditure threshold is met.	Various preferences for mining and quarrying industry — full deduction of exploration expenditure, allowable capital expenditure, transport facilities expenditure, and rehabilitation expenditure. Capital allowances such as 100 per cent tax deduction for capital investment in initial copyright of certain Australian films, tax rebate for interest on infrastructure borrowings (up to a limit).
Canada	Investment tax credits and special deductions allowed for current or capital R&D expenditures.	Investment tax credits for fixed assets acquired in economically disadvantaged areas. Special deduction (within limits) for certain capital exploration, development, property expenses from exploration for oil, gas and minerals in Canada and exploration and development expenses outside Canada. The 7 per cent tax credit for manufacturing and processing companies is being phased out.
Ireland	100 per cent capital allowance for capital expenditures by trading company; non-capital expenditures expensed currently. The *2004 Finance Act* introduced a corporation tax credit of 20 per cent for incremental qualifying R&D expenditure incurred by companies for R&D activities carried on in the European Economic Area (EEA). This is in addition to existing capital allowance for R&D.	10 per cent tax rate for much of manufacturing up to 2010. Accelerated depreciation (from 25 to 50 per cent) for buildings in designated areas. Ten-year double deduction of rent paid under qualified lease in designated areas.
Japan	Non-capital expenditures expensed currently, capital expenditures amortised over beneficial period. A corporation has two options for claiming tax credits for R&D. Under the draft 2006 Tax Reform, the existing R&D expense credit system will be expanded and an additional 5 per cent tax credit will be allowed for the portion of R&D expenses that exceeds 'comparative' R&D expenses (that is the average of those in prior years). This is a limited measure that will apply for two years, from fiscal years beginning during the period from 1 April 2006 to 31 March 2008.	**Investment tax credit** Certain small or medium-sized corporations that acquire or produce certain machinery or equipment may receive a credit against their corporation tax liability. The credit generally equals 7 per cent of cost or 20 per cent of the corporation tax, whichever is less. Under the draft 2006 Tax Reform, a special depreciation equivalent to 50 per cent or a tax credit equivalent to 10 per cent of the acquisition cost will be allowed for the acquisition of certain listed facilities that boost industrial competitiveness and promote the strengthening of the information systems, if the facilities are provided for domestic operations. Corporations with capital of ¥100 million or less will also be eligible for a tax credit on leasing investments, and a 10 per cent tax credit will be allowed on an amount equivalent to 60 per cent of total standard lease expenses. The tax credit will have a ceiling of 20 per cent of corporation tax, and it will be possible to carry forward excess credits for one year.

Appendix table 5.5.1: Corporate tax concessions (continued)

Country	Research and Development (R&D)	Others
Netherlands	Non-capital expenditures expensed according to sound business practice principle. Capital expenditures amortised over the useful life taking into account the residual value.	**Small business deduction** For employed and self-employed people there is an employment rebate of up to €1,213 (more for people in the age range 57 — 64, up to €1,935 less for 65 plus). **Environmental investment deduction** If you invest money in a recognised so-called 'green fund' you are entitled to a tax credit for socially responsible investments. The credit is 1.3 per cent of the average amount you invested during the year in a socially responsible way. In 2006, the maximum exempt amount per taxpayer is € 52,579. **Energy investment deduction** Since 1999, there are also tax incentives, an Energy Investment Deductions scheme, regulating energy tax and free depreciation of renewable energy installations via the Accelerated Depreciation on Environmental Investment Scheme.
New Zealand	Non-capital expenditures expensed currently, capital expenditures depreciable for tax purposes at applicable published rates.	Accelerated depreciation for all assets other than buildings. Mineral mining exploration and development costs 100 per cent deductible including for planned expenditure up to two years in advance of expenditure. Most forestry expenditure immediately deductible.
Spain	A tax credit equal to 30 per cent of expenditure on R&D incurred in the tax year is available. Where the expenses incurred exceed the average amount of expenses in the preceding two years, the rate of 30 per cent applies to an amount equal to the average, while a rate of 50 per cent applies to the excess. R&D activities may also benefit from a credit equal to 20 per cent of the costs relating to payroll and 10 per cent of the costs relating to investments in tangible (other than immovable property) and intangible assets used in the project.	A tax credit is available equal to 25 per cent of the investments made to set up foreign permanent establishments, or to acquire at least 25 per cent of the capital in existing foreign companies or in newly created foreign subsidiaries, provided the business activities of such permanent establishments, companies or subsidiaries are directly related to the export activities (other than finance and insurance activities) of the Spanish investor. Credits are also available for the costs of investment in cultural assets registered as national heritage, the costs of environmental protection, and expenses incurred in training personnel. Tax incentives, such as accelerated depreciation and a reduced tax rate, are available for small to medium-sized companies.
Switzerland	Tax provisions for costs of future R&D assignments to third-party contractors can be accounted for up to a maximum of 10 per cent of the taxable profit or CHF1 million.	Incentives for newly established corporations include full or partial exemption from sub-national taxes (and in certain cases national tax) for a period of up to 10 years after inception of business (conditions apply). In addition to sub-national tax holidays, tax incentives at the national level may be available to certain companies, such as holding or principal companies or to companies with sufficient economic substance in certain economical renewal areas (conditions apply). At the sub-national level special tax regimes (for example holding company, mixed company) may apply (rates depend on cantonal tax legislation).

Appendix table 5.5.1: Corporate tax concessions (continued)

Country	Research and Development (R&D)	Others
United Kingdom	R&D tax credits — small or medium-sized United Kingdom companies. 150 per cent of qualifying revenue-type expenditure on R&D is allowed for tax purposes in the accounting period the expenditure is incurred. A small or medium-sized company may be able to surrender the tax credits for a lesser cash amount from Her Majesty's Revenue and Customs if they have losses in the accounting period. R&D tax credits — large United Kingdom companies. 125 per cent of qualifying revenue-type expenditure on R&D is allowed for tax purposes.	Reduced tax rates for small business. First-year allowances are available for expenditure on plant and machinery incurred by small and medium-sized enterprises at a rate of 50 per cent (from April 2006, currently 40 per cent); expenditure on water-efficient technology assets, certain expenditure on energy-saving plant and machinery at a rate of 100 per cent; and expenditure on industrial buildings in qualifying enterprise zones at a rate of 100 per cent.
United States	Expenditures either expensed currently or capitalised for amortisation over 60 months (minimum). Tax credit for qualified expenditures, to the extent they have increased over a base period amount, limited to tax liability of that year. Excess credit carry back one year and carry forward 20 years.	Deduction or amortisation (over 10 years) for certain domestic exploration expenses. Foreign mining exploration and development amortisable over 10 years.

Source: Various, see Chapter 1 (1.4.1).

APPENDIX 5.6: ALTERNATIVE MEASURES OF THE CORPORATE TAX BURDEN

TAX TO GDP RATIOS

Tax to GDP ratios are a commonly used approach for comparing the level of taxation across countries. These measures can be calculated for taxes paid by particular industries or revenue heads and are calculated as total taxation revenue as a percentage of gross domestic product. Alternatively, they can be based on total corporate profits or income from national accounts.

$$Tax\ to\ GDP = \frac{Tax\ revenue}{GDP}$$

Tax to GDP ratios are a backward-looking measure of the tax burden. They provide an estimate of taxes paid on existing capital. To the extent that the taxation arrangements for new investment are different from the arrangements for existing investments, the measure may be limited in terms of estimating incentive effects.

Tax to GDP ratios typically do not take account of company and personal income tax integration. For example, they do not adjust for the tax benefit an imputation system provides to resident shareholders for company tax paid. Also, they do not account for foreign taxes paid.

Differences in tax to GDP ratios across time or across countries may not reflect differences in the tax burden. For example in the case of corporate income tax, the tax to GDP ratio can be expressed as follows:

$$\begin{aligned} Tax\ to\ GDP &= \frac{CIT}{\Pi} \times \frac{\Pi}{GDP} \\ &= \tau \times \frac{\Pi}{GDP} \end{aligned}$$

where CIT is corporate income tax paid, Π is profit and τ is the effective tax burden on economic profits. As the equation shows, variations in the tax to GDP ratio can actually reflect variations in the ratio of profit to GDP rather than differences in the effective tax burden.

In addition, taxes paid and GDP may not be related to the same year because of carried-forward losses. Such losses will tend to reduce tax paid in the period. Tax expenditures will also result in a reduction of the tax burden relative to an equivalent outlay.

In summary, tax to GDP ratios do not provide a reliable guide for measuring the tax burden and or providing information about incentives to invest.

STATUTORY TAX RATE

The statutory tax rate is the most basic and often used measure of for comparing tax arrangements across countries.

This measure is significantly limited as the effective rate faced by an investor is likely to be lower than the statutory rate. This is because taxable income generally does not correspond to economic income or accounting profits due to carried-forward losses and tax expenditures which reduce the tax base (for example income tax exemptions, statutory effective life caps and accelerated depreciation).

Comparisons of statutory tax rates can be unreliable for measuring the tax burden and provide limited information on incentives to invest.

EFFECTIVE CORPORATE TAX RATES

As noted earlier, there are many factors that create a difference between statutory and effective corporate tax rates. This means that the amount of tax actually paid may be significantly different from the amount of tax implied by applying the statutory tax rate to assessable income (taxable income equals assessable income less deductions).

Effective tax rates defined

An effective tax rate measures actual tax payable against actual income either for a historical or hypothetical set of circumstances and can be either backward-looking or forward-looking depending on the measure used. The problem with effective tax rates is they require researchers to make various assumptions and employ different methods to generate representative effective corporate tax rates, with the result that rankings of countries can vary depending on the assumptions/methods used.

Historically-based effective tax rate measures suffer from limited and sometimes inadequate data while effective tax rates for hypothetical investments are very stylised and cannot include all of the details of the relevant tax provisions (Kelly and Graziani 2004, p 29).

A United States' Congressional Budget Office (CBO) study, however, argues that it is possible to calculate meaningful effective corporate tax rates by focusing on the two factors (the tax treatments of depreciation and of different investment financing sources) that predominantly account for the divergence of statutory and effective corporate tax rates and for the variation among countries (Congressional Budget Office 2005, pp 15-16).

Average tax rate

Average tax rates (ATRs) are a commonly used approach to measure the taxation of capital income. This approach is based on micro data and expresses the effective tax burden as a percentage of tax liabilities relative to an income measure such as profits from annual accounts or total income from tax returns.

$$ATR_i = \frac{tax_i}{profit_i}$$

ATRs incorporate most aspects of the tax system such as variations in tax rates, tax deductions and tax offsets. ATRs also implicitly take into account impacts of tax planning, evasion and minimisation due to onerous or lax tax laws.

ATRs are also backward-looking. But given they are calculated using micro data they can be useful in determining the take-up rates of particular tax concessions. The measure may be limited in estimating incentive effects to the extent that the taxation arrangements applying to old and new capital may be different.

ATRs typically do not take account of company and personal income tax integration. For example, they do not adjust for the tax benefit an imputation system provides to resident shareholders for company tax paid. Also they do not account for foreign taxes paid.

ATRs are limited in their usefulness for evaluating incentives to invest as they are backward-looking but provide a good estimate of the tax burden if calculated correctly.

Effective marginal tax rate

The conventional approach to measuring an effective corporate tax rate is to calculate an effective marginal tax rate (EMTR), which sets the present value of a marginal investment's income stream equal to the present value of its cost. The EMTR concept stems from the theoretical approach of Jorgensen (1963), which calculates the effect of taxes on the cost of capital (the necessary real rate of return in pre-tax terms for an investment to break even). King and Fullerton (1984) used this approach in building measures of the EMTR which sought to measure the tax wedge between the rate of return to the investor and the rate of return to the saver.

The EMTR measures the tax on a marginal investment project and is defined as the difference between the pre-tax return ($\tilde{p}$) to the investor and the post-tax return (r) to the saver of the project divided by the pre-tax return (r can also be thought of as the cost of capital).

$$EMTR = \frac{\tilde{p} - r}{\tilde{p}}$$

A marginal investment is one where the investor is indifferent towards investing or not, that is, where the expected net present value of the investment is zero.

The EMTR is a forward-looking methodology, measuring the tax burden on a hypothetical investment. As such, the EMTR can be used to estimate incentive effects arising from the tax system.

Appendix table 5.6.1: Impact of EMTR on investment

Estimate of EMTR	Impact on investment
EMTR < 0	Investment is encouraged
EMTR = 0	No impact — that is, neutral
EMTR > 0	Investment is discouraged

EMTRs can be calculated at an asset, company or industry level. They can be calculated for all types of assets including intangibles, buildings, machinery, inventories and financial assets; and for all types of financing arrangements including new equity capital, profit retention, debt financing and leasing. The EMTR for a whole industry is simply the weighted average of separate EMTRs reflecting a particular combination of assets, financing and savers.

EMTRs can incorporate the effect of taxation on savers including individual shareholders, parent companies, financial intermediaries or tax exempt institutions.

EMTRs are an internationally accepted measure of the tax burden on capital income, but they are best suited to estimating incentive effects as they relate to a marginal project.

Effective average tax rate

Devereux and Griffith (1999) developed an alternative measure of the effective tax rate on investment projects, termed an effective average tax rate (EATR), which extended the conventional approach described above to calculate an average rate with respect to investments earning economic profit. The EATR is calculated with respect to the net present value of an investment's income stream for a given pre-tax rate of return. The net present value of the economic profit earned by such an investment is the difference between the present value of the income stream and the present value of the investment's cost.

In theory, the EATR can be calculated as the proportionate difference between the pre- and post-tax economic profit for a given pre-tax rate of return. But as Devereux and Griffith point out, this measure is undefined for a pre-tax marginal investment with zero economic profit (Devereux and Griffith 1999, p 6). They recommend a replacement EATR measure with the desirable feature that it is equal to the EMTR for a marginal investment.

More importantly from a policy viewpoint, EATRs may be a better marker of the tax incentives a multinational corporation confronts in deciding on a country for locating a large, discrete investment project, especially where the corporation has a strong expectation that it will earn economic profit due to a patent or similar source of market power. EMTRs, which relate to an investment just breaking even, may be more significant for deciding the level of investment once the country location decision has been made (Kelly and Graziani 2004, p 30).

The boxed section discusses in a technical manner the derivation of the EATR formula and its relationship to the EMTR.

Box 5.6.1: Effective marginal and effective average tax rates

To assist in understanding the development of the effective average tax rate (EATR) measure, it is constructive to commence with a tax inclusive effective marginal tax rate (EMTR) as

(1) $$EMTR = \frac{\tilde{p} - r}{\tilde{p}}$$

where $\tilde{p}$ is the marginal pre-tax rate of return and r is the cost of capital (Devereux and Griffith 2003, p 111).

The EATR is defined for $p \geq \tilde{p}$. Devereux and Griffith look at two measures of an EATR. Each is founded on the difference between the present value (R^*) of an investment that earns a pre-tax rate of return in excess of the normal rate of return and the present value when taxes are imposed (R). This difference between the value of an investment pre- and post-tax calculated as a proportion of the pre-tax value gives the first measure of the EATR as (Devereux and Griffith 2003, p 112):

(2) $$EATR\left(First\,measure\right) = \frac{R^* - R}{R^*}$$

with $R^* = \dfrac{p-r}{1+r}$

The problem with this first measure of the EATR is that it is undefined for an investment that is marginal before tax because the denominator in the formula would be zero. Devereux and Griffith resolve this issue by substituting in the denominator the net present value of the pre-tax total income stream, less depreciation, $p/(1+r)$, where p is the financial rate of return and r is the discount factor (real interest rate); and the investment is for one period only for simplicity in writing the formula (Devereux and Griffith 2003, p 112):

(3) $$EATR\left(Adjusted\,measure\right) = \frac{R^* - R}{p/(1+r)}$$

One advantage of using the adjusted EATR formula is that it can be manipulated to demonstrate its relationship to the EMTR. To illustrate this, it is helpful to express R using the cost of capital as:

(4) $$R = \left(p - \tilde{p}\right)\gamma\left(1 - \tau\right)\frac{\left(1 + \pi\right)}{\left(1 + \rho\right)}$$

with γ being a measure of the tax advantage between new equity and distributions; τ being the statutory corporate tax rate; π being the rate of inflation; and ρ being the shareholders' discount rate (Devereux and Griffith 2003, p 112).

Using equations (1), and (4) and the equation for R^* at the end of equation (2), the EATR can

be expressed as a weighted average of the EMTR and an 'adjusted statutory tax rate,' T (Devereux and Griffith 2003, p. 112):

(5) $$EATR = \left(\frac{\tilde{p}}{p}\right) EMTR + \left(1 - \frac{\tilde{p}}{p}\right) T$$

where

(6) $$T = 1 - \gamma (1 - \tau) \frac{(1 + r)(1 + \pi)}{1 + \rho}$$

It can be seen from the equation (5) that for a marginal investment since R=0 and $p = \tilde{p}$ (from equation (4)) then EATR=EMTR. On the other hand, for a highly profitable investment since $R^* \rightarrow \infty$ so $p \rightarrow \infty$ then EATR $\rightarrow T$ (Devereux and Griffith 2003, p. 112).

SUMMARY

In summary, there is no general effective tax rate concept for the purpose of measuring the tax burden and incentive effects of the tax system. The most appropriate measure will depend on the objective of the measurement.

For assessing allocative efficiency and tax incentives, the EMTR would be the most appropriate measure to use. If the aim of the tax burden comparison is to measure the impact of taxation on location decisions of large corporations, the EATR would be the more relevant approach.

The best indicators for analysing the impact of taxation on investment behaviour are forward-looking measures such as the EMTR and the EATR. The results for the EMTR and the EATR, however, are derived from models. As the assumptions underpinning any model are never fully representative, the impact of taxation on investment cannot be measured by these methods alone. Consequently, survey-based models such as the average tax rate can be used to provide additional insights into the tax burden on capital income.

INCIDENCE OF CORPORATE TAX

The debate over the most suitable measure of the corporate tax burden is mirrored by an unresolved debate over the economic incidence of corporate income tax. A United States' Congressional Budget Office study of the literature on the incidence of corporate income tax made the following tentative conclusions (Congressional Budget Office 1996, p 27).

- In the short term, the incidence of corporate tax is borne by shareholders and investors generally but not equally because some investments are more heavily taxed than others.
- The results of most models suggest that in a closed economy the long-term incidence of corporate tax is borne by capital in general, given reasonable assumptions.

- In an open economy, the burden of corporate tax in the long term may be moved to immobile factors but that transference is limited by the degree of substitutability of the capital and outputs of different countries.

- In the very long run, the burden of corporate tax is likely to be transferred to labour if the tax restricts capital accumulation.

- Most studies of the economic incidence of corporate taxation have overlooked the possibility of transferring the incidence through the effects on the relative prices of products, that is, transferring the burden to consumers.

Appendix 5.7: Corporate Capital Gains Taxation — OECD-10

Appendix table 5.7.1: Corporate Capital Gains Taxation — OECD-10

Country	Base	Rate (per cent) — scales are in local currency	Losses	Rollovers
Australia	Resident corporations are taxable on their worldwide capital gains. But resident corporations are exempt on gains from the sale of a foreign non-portfolio interest to the extent that the foreign interest has an underlying active business. Non-resident corporations are taxable on assets that have the necessary connection with Australia. (The 2005-06 Budget announced that non-residents would only be subject to tax on their real property and the business assets of their Australian branches. The Budget also included an interposed entities rule applying capital gains tax to non-portfolio interests in interposed entities where the value of such an entity is wholly or principally attributable to Australian real property.) There is an exit capital gains tax on corporations that cease to be resident in Australia.	Net capital gains are taxed at the corporate rate of 30 per cent.	Capital losses can only be offset against capital gains. Carry forward of capital losses is allowable but there are restrictions based on a continuity of ownership test and (for companies with a turnover of less than A$100 million) a same business test. Transfer of losses only possible within a consolidated group.	There are a range of rollovers and exemptions directed at small businesses. A wide range of replacement asset and same asset rollovers exist (including demerger and scrip-for-scrip) subject to various conditions being satisfied.
Canada	Resident corporations are taxed on their worldwide capital gains. Non-residents taxable on capital gains from 'taxable Canadian property', which is typically restricted by tax treaties. Depreciation recapture is included in the base. There is an exit capital gains tax on corporations that cease to be resident in Canada.	In general only half the capital gain is included in income and is then taxed at the usual rate of company tax, which ranges from 31 to 39 per cent depending on which province taxes the income (36.1 per cent for the representative combined rate).	Capital losses can only be used to reduce capital gains not ordinary income, unless the loss is attributable to shares or debt of a 'small business corporation'. The deductible portion of the capital loss is decreased by the inclusion rate. Carry forward indefinitely but only three years carry back. To stop corporations from trading in corporations with net capital losses or accrued losses, the corporation's taxation year is treated as though it ceased immediately before the change in ownership.	Certain same asset and replacement asset rollovers are allowed. Scrip-for-scrip rollover available if both companies are Canadian and prescribed rules are met.

Appendix table 5.7.1: Corporate Capital Gains Taxation — OECD-10 (continued)

Country	Base	Rate (per cent) — scales are in local currency	Losses	Rollovers
Ireland	Resident corporations are taxed on their worldwide capital gains. A schedular system operates with the principal types of income being subdivided into categories and sub-categories with differing rules determining the identification and calculation of income in each category. Non-resident companies are subject to corporate tax on capital gains on assets purchased or held for the purpose of carrying on a trade in Ireland through a branch or agency. Non-resident companies are subject to Irish capital gains tax on the disposal of Irish specified assets. The purchasing cost is indexed for inflation in calculating the capital gain. For sales of assets after 3 December 2002, indexation relief is available only for the period of holding the asset up to 31 December 2002. Capital gains arising from sales of substantial shareholdings are not subject to tax in particular circumstances.	The normal corporate tax rate for trading income is 12.5 per cent. Although the capital gains of resident companies are subject to corporate tax, they are taxed at the capital gains tax rate of 20 per cent. This is effected by taxing a notional amount of income at the corporation tax rate. Gains on certain sales of development land are taxed under a separate capital gains tax.	Capital losses can only be used against capital gains and can only be carried forward. Losses arising from the sale of development land are quarantined from other capital losses.	There is an effective rollover of the gain if a capital asset is transferred between members of the same capital gains group. A rollover may also be permitted for the purchase of shares or business assets in a merger or acquisition of a business.
Japan	Capital gains are added together with other income (meaning they are not taxed separately). Taxation of the domestic sourced income of foreign firms operating in Japan depends on what the firm is doing in Japan and on whether the firm has a permanent establishment in Japan.	For companies with capital not greater than ¥100 million, the corporate tax rate is 22 per cent on the first ¥8 million of taxable income and 30 per cent on any excess. For corporations with capital greater than ¥100 million the national corporate tax rate is 30 per cent. Local income taxes, which are comprised of local inhabitant tax and enterprise tax, are also imposed on corporate income. The resulting effective corporate income tax rate for corporations with capital greater than ¥100 million is approximately 40.69 per cent if the head office is located in Tokyo.	Current net operating losses ('NOLs') incurred by a corporation filing a blue form tax return may be carried forward for seven years and carried back for one year, and can be used to offset otherwise taxable income. Currently, the NOLs carry back rule is temporarily suspended, except for certain small and medium-sized companies subject to certain conditions. For corporations filing a white return, losses stemming from inventory, fixed assets or certain deferred assets caused by natural disaster can be carried forward for seven years. Other NOLs cannot be carried forward.	Where one company moves its assets and liabilities to another corporation as part of a reorganisation, no gain or loss arises from the movement if the reorganisation is a tax-qualified reorganisation.

Appendix table 5.7.1: Corporate Capital Gains Taxation — OECD-10 (continued)

Country	Base	Rate (per cent) — scales are in local currency	Losses	Rollovers
Netherlands	Resident corporations are taxed on their worldwide capital gains. Realised capital gains are treated as regular business profits whereas capital losses may be deducted when they can be reasonably anticipated. Capital gains and losses from qualifying shareholdings are exempt (non-deductible) under the participation exemption regime (see Appendix 5.2 for a list of conditions for participation relief to apply). For non-residents capital gains realised on the disposal of a permanent establishment asset or realised on immovable property are taxable if from a Netherland's source. If the non-resident shareholder has a substantial interest (more than or equal to 5 per cent) in a Dutch company the capital gains on a loan to the Dutch company will be taxable.	The corporate income tax rate is 25.5 per cent on the first €22,689 and 29.6 per cent on any balance.	Capital losses are deductible from tax base. There are restrictions on loss carry over where there is more than a 30 per cent change in ownership. Compensation of losses incurred in years during which a company's activities consisted exclusively or almost exclusively (at least 90 per cent) of holding and financing activities, with profits derived from newly acquired activities. Such losses can only be offset with profits of years during which the company's activities also consist exclusively or almost exclusively of holding or financing activities. Compensation of losses is disallowed if the balance of the related-party receivables and the related-party payables of a company with holding losses, during the financial year in which a profit has been realised, exceed that balance in the financial year the losses were incurred. Consolidated groups (fiscal unity) can offset losses of one company against the income of another company in a particular year.	Gains arising from the disposal of business assets may be deferred if put in a reinvestment reserve for replacing or repairing business assets within three years. Equalisation reserve enables recurring but not annual costs to be spread more equally over time.
New Zealand	Capital gains are generally not taxed.	Capital gains associated with disposal of patent rights and property held on revenue account are deemed to be income and taxed at the standard corporate rate of 33 per cent.	n/a	n/a
Spain	Capital gains are generally taxed as ordinary income. Resident companies are generally taxable on their worldwide capital gains. Capital gains of a resident company obtained from the sale of shares in a non-resident company are exempt where the requirements of the affiliation privilege are satisfied, although the exemption may be limited in specific circumstances.	The general company tax rate is 35 per cent. Corporations with yearly net sales not greater than €8 million pay a 30 per cent rate on the first €120,202.41 of annual profits, with any excess taxed at 35 per cent. A surcharge of between 0.01 per cent and 0.75 per cent applies to corporate income tax due and is deductible for corporate income tax purposes. If particular reinvestment conditions are satisfied, capital gains may attract a tax credit decreasing the corporate tax rate to 15 per cent.	Capital losses are treated the same as ordinary losses. Losses may be carried forward 15 years but no carry back is allowed. If there is a change in ownership then a restriction on the carry forward of losses applies in particular circumstances.	

Appendix table 5.7.1: Corporate Capital Gains Taxation — OECD-10 (continued)

Country	Base	Rate (per cent) — scales are in local currency	Losses	Rollovers
Spain (continued)	The capital gains derived by a permanent establishment of a non-resident company are given differing treatment according to their source. Domestic capital gains are treated under the general rules for taxing capital gains. Foreign capital gains may benefit from the exemption under the affiliation privilege. The capital gains of non-resident companies not having a permanent establishment are subject to the same tax rules that apply to resident companies and are taxed at the corporate income tax rate unless they fall into one of the categories of exempt gains. Indexation of the acquisition cost is permitted only for sales of immovable property. Capital gains arising from the disposal of participations in resident entities are exempt from tax in particular circumstances but it applies only to that part of the net capital gain attributed to non-distributed profits. Alternatively, a 20 per cent tax credit is given for sales of minimum participations, reinvested capital gains or transfers of particular assets if certain conditions are met: (1) the gain arises from a transfer of tangible or intangible fixed assets or from a minimum participation interest of 5 per cent held for at least one year; (2) all the proceeds are reinvested in similar types of assets within four years (from one year before the transfer to three years afterwards); and (3) the new assets are kept for at least three years (five years for immovable property), unless their useful life is shorter. Capital gains arising from donations to qualifying entities are exempt.			Deferral available on capital gains arising due to a corporate restructuring.

Appendix table 5.7.1: Corporate Capital Gains Taxation — OECD-10 (continued)

Country	Base	Rate (per cent) — scales are in local currency	Losses	Rollovers
Switzerland	**National** Capital gains arising from the sale of movable and immovable business property are taxable. Resident companies are taxed on offshore capital gains, apart from gains on immovable property and gains on movable property of an enterprise or permanent establishment situated abroad. The cantons use the same approach. Non-resident companies are taxable on capital gains arising from Swiss businesses, permanent establishments or immovable property. There is capital gains relief on gains where the seller has a substantial participation in a resident or non-resident company and certain conditions are met. The cantons adhere to the same practice. Gains deriving from the sale of real estate are not subject to a special real estate gains tax at the national level, that is such gains are subject to the ordinary federal tax. **Cantonal** At the cantonal level, capital gains on movable property are taxed while gains on immovable business property may be taxed under either the corporate income tax (dualistic system) or the real estate gains tax (monistic system) depending on the canton in which the property is situated. The canton of Zurich uses the monistic approach.	The corporate tax rate is an aggregate of national, cantonal and municipal components. **National** The national rate is levied at 8.5 per cent but the national tax liability is deductible, yielding an effective rate of 7.83 per cent. **Cantonal** The cantonal rate depends on the cantonal tax legislation. At the cantonal and municipal level, the so called tax tariff consists of the tax rate and a cantonal and municipal multiplier. In the City of Zurich the overall effective tax rate for cantonal and municipal taxes amounts to approximately 16 per cent. Rates of the real estate gains tax (monistic system) are fixed by the cantons and depend on two factors in nearly every canton, that is the amount of the respective gain on the sale of real estate and ownership period. So, the tax rate decreases as the period of ownership increases. In the canton of Zurich, gains subject to the real estate gains tax are exempt for the first CHF5,000. After CHF5,000 progressive rates apply ranging from 10 per cent on the first CHF4,000 to 40 per cent on any balance greater than CHF100,000. The tax is increased by 50 per cent if the asset is owned for less than one year and by 25 per cent for periods less than two years. Where the asset has been owned for at least five years, the tax is decreased by 5 per cent and for each additional year by three per cent with the highest decrease permitted being 50 per cent.	Capital losses realised on the sale of movable property are subject to the normal loss rules. At the national and cantonal levels, losses may be carried forward for up to seven years. Generally there is no carry back of losses except in the canton of Thurgau where they can be carried back one year. Under the dualistic system, losses on the sale of immovable property may generally be offset against other income and gains. Under the monistic system, capital losses on the sale of immovable property may not be used against gains realised on the disposition of real estate because the real estate tax relates to the sold assets and not to total income. Several cantons do not follow this approach and permit the offset of monistic losses under particular conditions. Zurich allows a loss on the sale of a portion of immovable property to be offset against a gain on the sale of another portion of the same property.	Rollover relief is available for the replacement of fixed assets in Switzerland. There is a deferment of tax on capital gains on hidden reserves resulting from a merger, division or transformation if certain conditions are met. Deferral of tax on hidden reserves on participations is allowed in all cantons where the modification due to the new Merger Law is implemented (by 1 July 2007 the latest), where there is a substantial participation in a resident or non-resident company (20 per cent), and where ownership period was at least one year.

Appendix table 5.7.1: Corporate Capital Gains Taxation — OECD-10 (continued)

Country	Base	Rate (per cent) — scales are in local currency	Losses	Rollovers
United Kingdom	United Kingdom tax resident companies are taxed on their worldwide capital gains which are subject to company tax at the usual rates. Where all the conditions are met, a capital gain arising on the sale of shares in a trading subsidiary can be exempt under the Substantial Shareholdings Exemption. In very broad terms this involves both the investor and investee company meeting the definition of a qualifying trading company before and after the disposal, a minimum share ownership and minimum period of ownership. Non-United Kingdom tax resident companies are subject to tax on their capital gains only where such gains are attributable to a United Kingdom permanent establishment unless exempt under a double taxation treaty. Where United Kingdom tax resident companies seek to emigrate from the United Kingdom there is a capital gains tax exit charge based on a deemed sale and reacquisition of its assets on departure.	The current rates of corporate tax in the United Kingdom are either 0 per cent or 19 per cent for small companies and 30 per cent for large companies (with the effective marginal rates of tax between the bandings, to bring average rates up to the 19 per cent and 30 per cent rates, shown below). Bandings are reduced proportionately where a company has associated companies. Taxable profits Up to 10,000 — 0 10,001 — 50,000 — 23.75 50,001 — 300,000 — 19 300,001 — 1,500,000 — 32.75 Over 1,500,000 — 30 Small companies in the 0 per cent band are taxed at the 19 per cent rate on profits they pay out to non-corporate shareholders under the non corporate distribution rate. It has been announced that the *Finance Act 2006* will abolish the 0 per cent rate and also the non-corporate distribution rate. This will result in the corporation tax rates of 19 per cent and 30 per cent remaining (with marginal relief between the bandings).	Corporate capital losses can only be offset against capital gains in the same or subsequent accounting periods. Excess capital losses may be carried forward indefinitely. In general, capital losses generated by a company before it is acquired can only be used in very limited circumstances by a new owner. This also applies to capital losses inherent in assets acquired by way of a share acquisition.	A form of rollover relief is available for certain (share-for-share) corporate reorganisations undertaken for bona fide commercial reasons. There is an advance clearance procedure to provide comfort that a reorganisation will not result in a disposal for capital gains tax purposes. Another form of rollover relief applies to companies realising capital gains where the proceeds from the disposal are used to acquire qualifying replacement assets. Transfers of assets between United Kingdom resident companies within a corporate group are undertaken on a no gain/no loss basis. The gain will however crystallise where the transferor or transferee ceases to be part of the same corporate group within six years of the transfer.

Appendix table 5.7.1: Corporate Capital Gains Taxation — OECD-10 (continued)

Country	Base	Rate (per cent) — scales are in local currency	Losses	Rollovers
United States	Resident corporations are taxed on their worldwide capital gains at the same rates as for ordinary income. Foreign corporations are subject to tax on capital gains where such gains are effectively connected to a United States trade or business. For a corporate group filing a consolidated United States national income tax return, the net capital gain is calculated across the entire group. Certain qualifying scrip-for-scrip or scrip-for-asset exchanges may be exempt from tax.	Up to 50,000 15 50,001 75,000 25 75,001 100,000 34 100,001 335,000 39 335,001 10,000,000 34 10,000,001 15,000,000 35 15,000,001 18,333,333 38 Over 18,333,333 35 Note that the average rate is never higher than 35 per cent; the purpose of the 38 per cent and 39 per cent brackets is to eliminate the benefit of low rates on the lower brackets for higher-income taxpayers.	Corporate capital losses can only be offset against capital gains. Excess capital losses may be carried back three years and carried forward five years. Note that all dispositions of business property for a year are netted. If there is an overall net gain, it is treated as a capital gain. If there is an overall net loss, it is treated as an ordinary loss, and so not subject to the limits on capital losses.	Rollover relief is available for certain incorporation, liquidation and reorganisation transactions. Rollover relief may also be available in certain situations for business or investment property that is exchanged for similar property and for certain compulsory conversions of property.

Source: Various, see Chapter 1 (1.4.1).

Chapter 6

Capital income taxation

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6. CAPITAL INCOME TAXATION

SUMMARY

The capital income of individuals is taxed in many different ways around the world. In recent years, there has been a particular focus on the method of integration of the corporate and personal levels of taxation. Many European countries have tended to move away from full imputation, to systems where dividends are taxed at lower rates at the personal level.

Australia is one of only a small number of OECD-30 countries that have a dividend imputation system (where the credit depends on company tax paid). Unlike most of the other OECD countries with an imputation system, Australia's system refunds excess imputation credits eliminating the double taxation of dividends. Most OECD countries use a credit system (where the credit does not depend on company tax paid) or have a modified classical system with a reduced rate on dividends to relieve the double taxation of dividend income.

Australia has the third lowest top overall tax rate of the OECD-10 on dividend income, taking account of tax at both the company and the shareholder level.

Australia has the second lowest overall tax rate of the OECD-10 on dividend income for an individual earning the average wage, taking account of tax at both the company and the shareholder level.

All of the OECD-10 countries, including Australia, provide some form of concessional treatment for capital gains.

Australia has the third highest top capital gains tax rate for shares held between one and two years, and the second highest top capital gains tax rate for shares held for ten years, of the OECD-10. Two countries in the OECD-10 exempt capital gains on shares (New Zealand and Switzerland) while four countries provide a capital gains allowance (Canada, Ireland, Japan and the United Kingdom).

Most countries in the OECD-10 have a lower tax rate on interest income compared with the tax rate on wage and salary income. In many cases, this is because social security contributions do not apply to capital income.

Australia has the highest top marginal personal tax rate on interest income of the OECD-10, and is around 11 percentage points above the OECD-10 average (37.1 per cent). A number of the comparator countries also provide exemptions for certain interest income.

This chapter also examines the extent of the difference between tax rates on wages and salaries and the tax rates on corporate income. Of the 30 OECD countries, only one, the Slovak Republic, has aligned its top marginal personal tax rate and full statutory corporate tax rate.

Australia's difference (18.5 percentage points) is only slightly above the OECD-30 average (17.8 percentage points). Australia has the fourth highest difference across the OECD-10 and is around four percentage points above the OECD-10 average (14.9 percentage points).

6.1 INTRODUCTION

The accumulation and efficient allocation of capital is pivotal to the growth of every economy. As such, the taxation of capital income raises important issues concerning its effect on incentives to save and invest, on resource allocation, on risk taking and on entrepreneurship.

This chapter examines the taxation of domestically-sourced capital income of domestic individual taxpayers amongst the OECD-10. It considers taxes paid on:

- dividend income — including the integration of the personal and corporate tax systems;
- capital gains; and
- interest income.

Taxes on property (rent), royalties and capital deductions such as depreciation and interest expense are not covered, while the taxation of retirement savings and foreign source income are covered in Chapters 7 and 10.

Despite the importance of capital taxation, most cross-country analysis is focused on corporate taxation. Given the limited comparative information available on capital income taxes at the personal level, this chapter is largely based on OECD estimates of the top tax rate applying to the three types of capital income noted above. While this provides an interesting comparison, it has three key limitations:

- the actual tax rate faced by the investor is likely to be lower because most countries have preferential tax arrangements applying to specific types of capital income;
- the estimate ignores the taxation of lower income individuals; and
- the estimate does not represent the true tax burden faced by the investor, because the effective rate of tax may be significantly different.

Estimates of effective marginal tax rates (EMTRs) for investments are potentially more useful. EMTRs measure the tax burden faced by an individual investor as the fraction of the pre-tax rate of return on a new investment that is collected as tax. Such measures are complex and comparative studies are generally limited to investments made by companies in physical assets and exclude taxation at the shareholder level (see Chapter 5). As a result EMTRs are not presented.

This chapter also examines the extent of the difference between tax rates on wages and salaries (Chapter 4), and the tax rates on corporate income (Chapter 5).

6.2 CAPITAL TAXATION

Capital income is taxed in many different ways around the world. Even within the OECD-10 approaches vary significantly.

The two general approaches to taxing capital income are to:

- treat capital income as ordinary income, which is taxed at personal income tax rates (similar to the approach of Australia, Canada and New Zealand); or
- separate capital income from ordinary income, and tax it at different rates — so-called schedular taxation (similar to the approach of the Netherlands, see Box 6.1).

Most countries use combinations of the two depending on the source of the capital income.

In addition to these broad differences there are also significant differences between: the calculation of taxable capital gains; systems of shareholder relief; and the treatment of capital gains (the later two are covered in detail below).

In relation to the calculation of taxable capital income, most of the OECD-10 tax realised capital income. The one exception is the Netherlands, where most taxable capital income is calculated based on a deemed rate of return on all capital producing assets held by the taxpayer (see Box 6.1).

Many countries also have tax preferred savings accounts outside of retirement savings. Tax preferred savings accounts depart from comprehensive income taxation (where deposits and earnings are taxed and withdrawals are not), with earnings exempt and withdrawals either exempt or taxed at a lower rate.

Box 6.1: Schedular taxation — the Netherlands' box system

Of the OECD-10, the Netherlands has the closest tax system to a pure schedular arrangement.

The Netherlands introduced its current schedular (or box) system as part of the 2001 tax reform. Under this system an individual's income is classified into one of three boxes. The income of each box is calculated separately with a different tax rate applying to the income for each box.

- Box 1: includes wages and salaries, social security payments and pensions and income from owner-occupied dwellings (based on a deemed rental value) less allowable deductions. Net income is taxed at progressive rates ranging from 34.4 per cent to 52 per cent (including social security contributions).
- Box 2: includes capital gains and other income from substantial shareholdings. This includes dividends and capital gains where the shareholder controls at least 5 per cent of the company. Net income for substantial shareholdings is taxed at a flat rate of 25 per cent.
- Box 3: is the taxation of capital income, including income from non-substantial shareholdings. Instead of taxing realised capital income, income-producing assets of the taxpayer are deemed to produce a yield of 4 per cent, which is taxed at a flat rate of 30 per cent. This is equivalent to a 1.2 per cent wealth tax (30 per cent x 4 per cent).

The effect of this type of schedular taxation is that capital income is taxed at lower rates than wages and salaries, while income and losses cannot be transferred across boxes.

6.3 Dividend income

Policy interest in the taxation of dividends has increased across OECD countries in recent years. In particular, there has been a focus towards reconsidering the relative advantages and disadvantages of integrating the corporate and personal levels of taxation on distributed profits. Many European countries have tended to move away from full imputation systems to systems where dividends are taxed at lower rates at the personal level. Australia has a full imputation system.

The following section provides a brief overview of the various shareholder relief systems. This is followed by a comparison of tax rates applying to dividends across the OECD-10.

6.3.1 The taxation of dividend income: classical versus shareholder relief systems

Classical system

Under a pure classical system, companies and shareholders are treated as separate entities with profits being taxed first at the company level. The post-tax profits are then taxed at the shareholder level when distributed, resulting in full economic double taxation of the income.

Economic efficiency considerations lie behind arguments for eliminating the double taxation of dividends, with taxation influencing at least three kinds of decisions:

- the corporate financing decision between debt and equity;
- the choice to hold or distribute profits; and
- whether or not to incorporate an enterprise (OECD 1991, p 168).

Shareholder relief systems

Shareholder relief systems aim to reduce the full economic double taxation that applies under a pure classical system. Shareholder relief systems may be implemented at either the company or shareholder level or both. Table 6.1 lists the general types of shareholder relief systems and Appendix 6.1 provides details of the shareholder relief systems and the degree of integration of company and individual taxation for the OECD-10.

Table 6.1: General types of shareholder relief systems

Company level		Shareholder level	
Type of relief	**Comment**	**Type of relief**	**Comment**
Dividend deduction	Provide a full or partial deduction for distributed profits.	Dividend exclusion	A proportion of dividend income is excluded from taxation.
Credit	Provide a full or partial credit to the company for distributed profits.	Credit	Provide a full or partial credit to the taxpayer for dividends received.
Reduced rate	Reduce the tax rate for distributed profits.	Reduced rate	Reduce the tax rate for dividends received.

The credit and reduced rate shareholder relief systems can be designed to eliminate fully the economic double taxation of corporate income that applies under the pure classical system. The reduced rate system can only ever partially eliminate the economic double taxation of corporate income unless the rate is reduced to zero.

Australia's imputation system is a very pure form of credit relief at the shareholder level where the credit is related to the amount of Australian tax that has been paid at the corporate level and is fully refundable in the hands of the company's shareholders. The Australian system almost fully removes the double taxation of domestic income of domestic shareholders.[1]

The Australian imputation system is relatively neutral with respect to the corporate financing decision but raises issues concerning Australian companies earning foreign source income and their shareholders, who do not obtain imputation credits for foreign corporate tax paid by a branch or subsidiary of an Australian resident company. However, Australia's approach is consistent with the national neutrality benchmark.

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1 The only double taxation that could remain for such shareholders relates to the capital gains they realise in an Australian company that held undistributed profits that had been subject to Australian tax. If the market price of the shares reflected the company's franking account balance all double taxation would be eliminated. To the extent that the market price did not reflect the franking account balance then some double taxation could remain. This aspect of double taxation on retained corporate income is common with most other shareholder relief systems.

Other forms of credit and shareholder relief systems provide relief regardless of whether home country tax has been paid. This reduces or eliminates the non-neutrality between domestic and foreign source income for domestic companies and their shareholders.

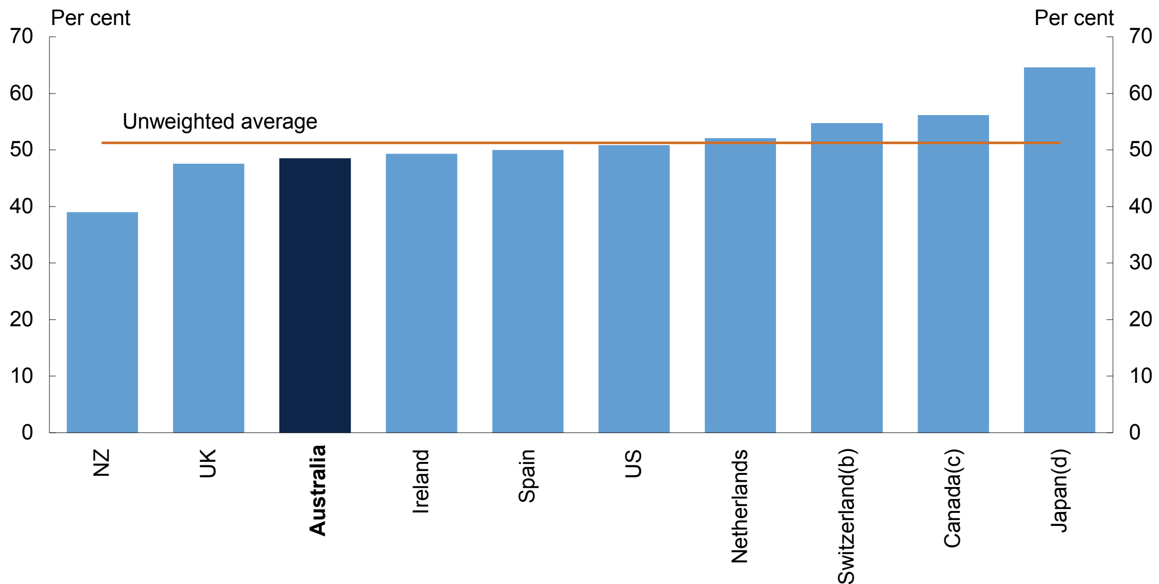
6.3.2 Tax rates applying to dividend income

Chart 6.1 illustrates the top overall statutory tax rates on distributions of domestic source income to a resident individual shareholder, including corporate income tax, personal income tax and any type of integration or relief to reduce the effects of double taxation. The chart shows that Australia’s top overall tax rate on dividends sourced from domestic profits (48.5 per cent) is the third lowest of the OECD-10 and is around three percentage points below the average (51.2 per cent) of those countries.

The top overall tax rate on dividends is equal to the top marginal personal tax rate on labour income in Australia, the Netherlands and New Zealand. [2] For Australia and New Zealand, this highlights the use of a full imputation system (where the credit depends on company tax paid), while for the Netherlands it is a feature of their schedular taxation arrangement. For the remaining countries, the top overall tax rate on dividends is greater than the top marginal personal tax rate, which primarily reflects their integration systems only providing partial relief of the double taxation of dividend income.

2 The top marginal personal tax rate is the all-in top marginal tax rate as calculated by the OECD. The all-in top marginal tax rate includes national and sub-national government personal income tax, plus employee social security contributions (as well as the impact of deductibility of social security contributions from national government taxes), resulting from a unit increase in gross wages.

Chart 6.1: Top overall statutory tax rates on domestic source dividend income[(a)]
OECD-10, 2005

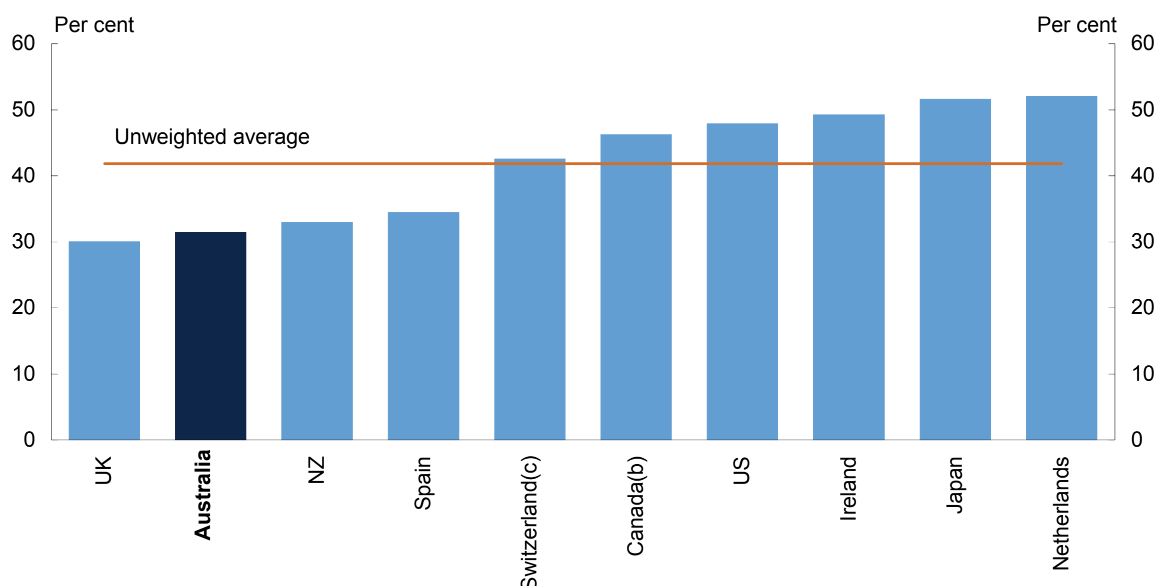


(a) Overall statutory tax rates on distributions of domestic source income to a resident individual shareholder, incorporating corporate income tax, personal income tax and any type of shareholder relief.
(b) The corporate income tax rate includes the church tax, while the personal income tax rates excludes it.
(c) Canada recently announced a reduction in personal income taxes on eligible dividends. See http://www.fin.gc.ca/news05/data/05-082_1e.html for further details.
(d) The 2005 rate for Japan was not available; the 2004 rate is presented.
Source: OECD Tax Database.

Chart 6.2 illustrates the overall statutory tax rates on distributions of domestic source income to a resident individual shareholder earning the average wage, including corporate income tax, personal income tax and any type of integration or relief to reduce the effects of double taxation.[3] The chart shows that Australia's overall tax rate on dividend income for an individual on the average wage (31.5 per cent) is the second lowest of the OECD-10 and is around 10 percentage points below the average (41.9 per cent) of those countries.

3 For Australia, the average wage is $51,169.

Chart 6.2: Overall statutory tax rates on domestic source dividend income — average production worker(a)
OECD-10, 2005



(a) Overall statutory tax rates on distributions of domestic source income to a resident individual shareholder, incorporating corporate income tax, personal income tax and any type of shareholder relief. OECD estimates for Japan, Spain and Switzerland were not confirmed by the responsible agency in each country.
(b) The corporate income tax rate includes the church tax, while the personal income tax rate excludes it.
(c) Canada recently announced a reduction in personal income taxes on eligible dividends.
See http://www.fin.gc.ca/news05/data/05-082_1e.html for further details.
Source: OECD estimates (unpublished).

6.4 Capital gains

Typically capital gains are taxed on a realisation basis rather than an accruals basis. This introduces a deferral tax advantage to the asset holder but, depending on the particular system of capital gains tax (CGT), the asset holder may be taxed on nominal rather than real capital gains on sale of the asset.

Capital gains are taxed in many different ways around the world. New Zealand does not impose CGT and of those that have a CGT regime some have a stepped rate (as the holding period increases the tax rate decreases), some have a flat rate and others (such as Australia and Canada) use a discount system for taxing capital gains (only a proportion of the gain is taxable).

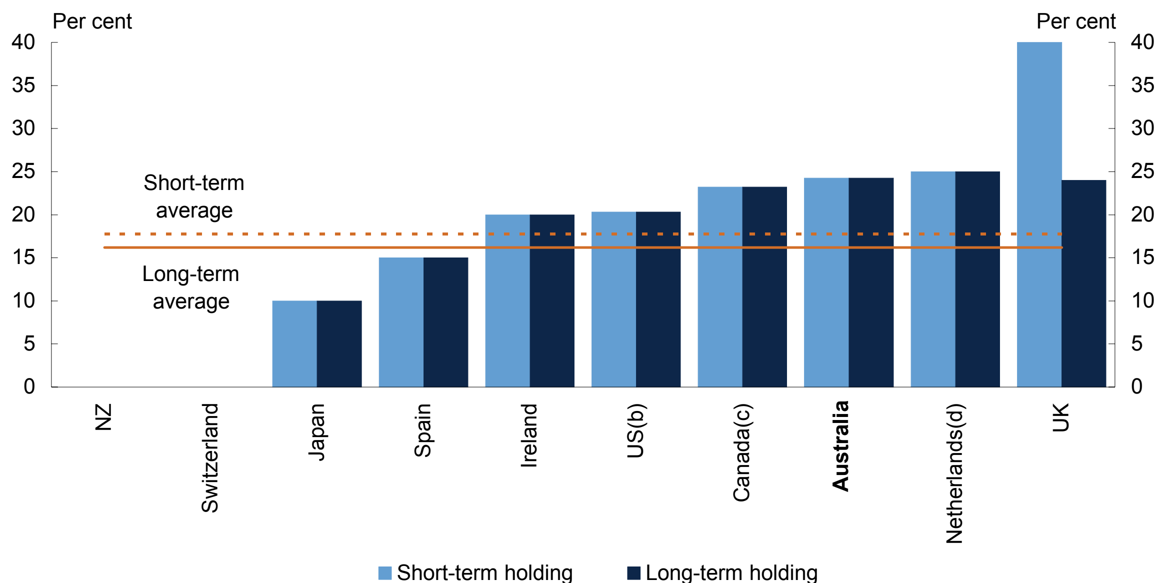
Although New Zealand does not have a general CGT regime, it has redrawn the boundary between revenue and capital to ensure that particular types of short-term gains are classified as normal operating taxable income (Desai 2006, p 1083). Examples of this include gains on the sale of personal property if the taxpayer is a trader in such property; gains from the disposal of land where the intention at the time of purchase was to sell it; and gains on domestic corporate bonds that are accruals taxed (OECD 2004, p 6).

Chart 6.3 provides either the top marginal tax rate or the flat rate, whichever is applicable on capital gains derived by the sale of shares. In the first scenario (short-term) the shares have been held for more than one year but less than two years before sale; while in the second

scenario (long-term) the shares have been held for ten years before sale. The tax rates are nominal not effective.

For the short-term holding period, Australia's top marginal tax rate (24.3 per cent) is the third highest of the OECD-10 while for the long-term holding period Australia's rate (24.3 per cent) is the second highest. The comparator country average for the short-term holding period is 17.8 per cent, while the corresponding figure for the long-term holding period is 16.2 per cent. These averages are low because two of the OECD-10 (New Zealand and Switzerland) do not tax capital gains on the sale of particular forms of shares.

Chart 6.3: Top marginal tax rate on capital gains on shares[(a)]
OECD-10, 2005-06



(a) Where relevant based on top marginal income tax rates, short-term holdings are greater than one year but less than two years, long-term holdings are where the shares have been held for 10 years.
(b) The rate includes federal, state and city taxes with the last two being based on Michigan and Detroit.
(c) Cumulative life-time capital gains exemption (C$500,000) under certain conditions. Rate includes national and sub-national taxes, the latter being based on the representative Province of Ontario.
(d) For substantial shareholders (direct or indirect ownership of more than 5 per cent); otherwise exempt.
Source: various, see Chapter 1 (1.4.1).

Some OECD-10 countries provide a capital gains allowance: Canada has a cumulative lifetime capital gains allowance; Ireland and the United Kingdom provide a yearly capital gains allowance; and Japan offers a capital gains allowance depending on the type of asset.

Switzerland does not tax capital gains on shares and the Netherlands only does so for gains on substantial shareholdings (greater than five per cent ownership).

Table 6.2 provides the same comparison for the OECD-30. The results should be treated with care as they only present the capital gains tax treatment on shares and not the taxation of dividends. It shows that for the short-term holding period, Australia's marginal tax rate (24.3 per cent) is the eight highest of the OECD-30 while for the long-term holding period Australia's rate (24.3 per cent) is the seventh highest. The OECD-30 average for the short-term holding period is 15.2 per cent, while the corresponding figure for the long-term holding period is 14.0 per cent. These averages are low because ten of the OECD-30 exempt from taxation capital gains on the sale of particular forms of shares and, as noted earlier, New Zealand does not have a general CGT system.

Of the OECD-30, only two countries (Denmark and the United Kingdom), have a reduced rate for gains on assets held for 10 years compared with assets held for between two to three years. However, the top long-term rate in Australia is significantly lower than the rate applying in Denmark (43.0 per cent) and is only slightly above the rate applying in the United Kingdom (24.0 per cent).

Table 6.2: Top marginal tax rate on capital gains on shares — OECD-30, 2005-06[a]

Country	MTR (held more than one year but less than two years)	MTR (held more than 10 years)
Australia	24.3	24.3
Austria	0.0	0.0
Belgium	0.0	0.0
Canada[b]	23.2	23.2
Czech Republic	0.0	0.0
Denmark	62.9	43.0
Finland[c]	29.0	29.0
France[d]	27.0	27.0
Germany	0.0	0.0
Greece	0.0	0.0
Hungary	20.0	20.0
Iceland	10.0	10.0
Ireland	20.0	20.0
Italy[e]	12.5	12.5
Japan	10.0	10.0
Korea[f]	20.0	20.0
Luxembourg	0.0	0.0
Mexico[g]	0.0	0.0
Netherlands[h]	25.0	25.0
New Zealand	0.0	0.0
Norway	28.0	28.0
Poland	19.0	19.0
Portugal	0.0	0.0
Slovak Republic	19.0	19.0
Spain	15.0	15.0
Sweden	30.0	30.0
Switzerland	0.0	0.0
Turkey	0.0	0.0
United Kingdom	40.0	24.0
United States[i]	20.3	20.3
Average	15.2	14.0

(a) Where relevant based on top marginal income tax rates.
(b) Cumulative life-time capital gains exemption (C$500,000) under certain conditions. Rate includes federal and provincial taxes, the latter being based on the representative Province of Ontario.
(c) The taxpayer may use a maximum presumed acquisition cost of 20 per cent (50 per cent for assets held for 10 years or longer) of the sale price.
(d) There are special exemptions for gains on an interest in a qualifying 'innovative new company'.
(e) Qualified/substantial shareholding in listed company; 40 per cent inclusion in 'other income' taxed at marginal personal income tax rates.
(f) For substantial shareholding of quoted shares and non-substantial holding of unquoted shares.
(g) For quoted shares.
(h) For substantial shareholders (direct or indirect ownership of more than 5 per cent); otherwise exempt.
(i) The rate includes federal, state and city taxes with the last two being based on Michigan and Detroit.
Source: various, see Chapter 1 (1.4.1).

6.4.1 Capital losses and rollover relief

Most of the OECD-10 provide carry forward of capital losses and several allow carry back of capital losses, although in most cases with restrictions (Canada, Ireland, the Netherlands and the United Kingdom). Several countries also allow capital losses to be set off against ordinary income (Canada, the Netherlands, Spain and the United States) but typically only in certain circumstances. Japan allows capital losses to be set off against total income over the next three years but only on the sale of residential property with some restrictions.

Most OECD-10 countries (except Japan and the United States) provide an exemption/rollover (sometimes subject to conditions) from CGT for a capital gain derived from the sale of a principal residence. The United States only taxes gains above US$250,000 (individual taxpayer) and offers deductions for home mortgage interest subject to particular limits.

More generally, all the OECD-10 provide replacement asset and same asset rollover with the exception of Spain, which only provides the former, and New Zealand, which does not have a CGT regime.

Appendix 6.2 provides more detailed information on the taxation of capital gains in the OECD-10 countries.

6.5 INTEREST

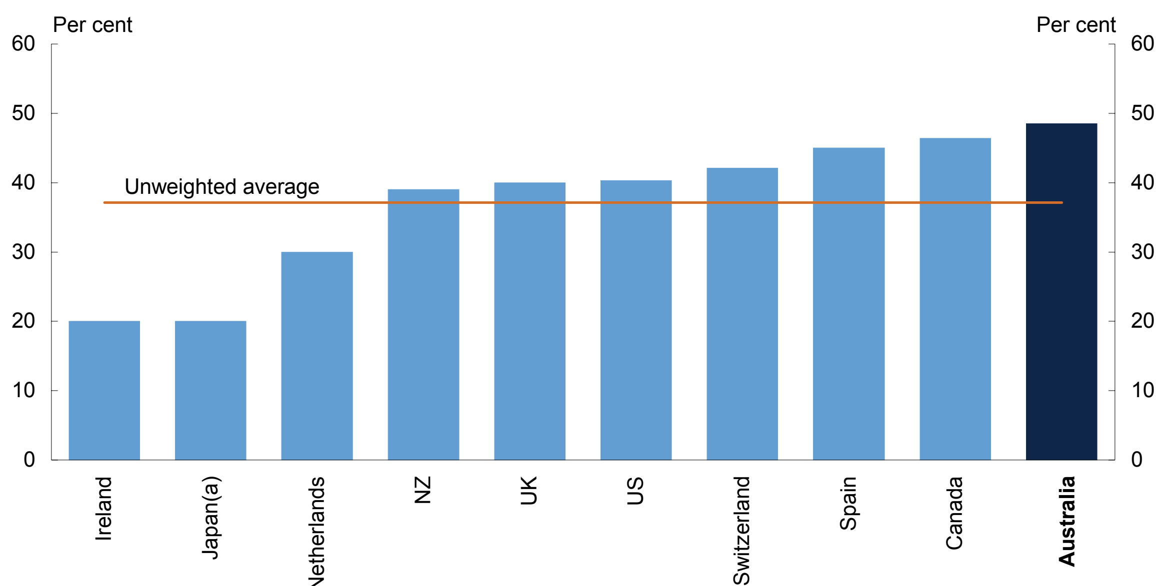
Over half of the OECD-10 treat interest income as ordinary personal income for taxation purposes, namely: Australia, Canada, New Zealand, Spain, Switzerland, the United Kingdom and the United States.[4] Japan and Ireland impose final withholding taxes on interest at source while the Netherlands, which uses a schedular tax system, taxes an imputed return on deposits.

Chart 6.4 shows that Australia's top overall tax rate on interest income from ordinary bank accounts (48.5 per cent) is the highest of the OECD-10 and is around 11 percentage points above the average (37.1 per cent) of the OECD-10.

Many countries in the OECD-10 have a lower tax rate on interest income compared to the personal tax rate on wages and salaries (the exceptions are for example, Australia and New Zealand). This generally arises because social security contributions apply to wage and salary income and not to capital income. For the Netherlands a lower tax rate on capital income is a key feature of their schedular approach to taxation (see Box 6.1), while as noted above Ireland and Japan use a final withholding tax arrangement for interest.

4 In the United Kingdom 'income from savings, including interest arising to a UK-resident individual on an account with a UK bank or building society is normally paid with tax deducted at the lower rate of tax. Basic rate taxpayers do not have to pay additional tax, but higher rates of tax are assessed if applicable on the gross interest' (CCH Tax Handbook 2005-06, pp 9,011).

Chart 6.4: Top marginal tax rate on interest from ordinary bank accounts
OECD-10, 2005



(a) Japan provides an exemption for interest accrued from current bank deposits, however interest from other deposits is taxable.
Source: various, see Chapter 1 (1.4.1).

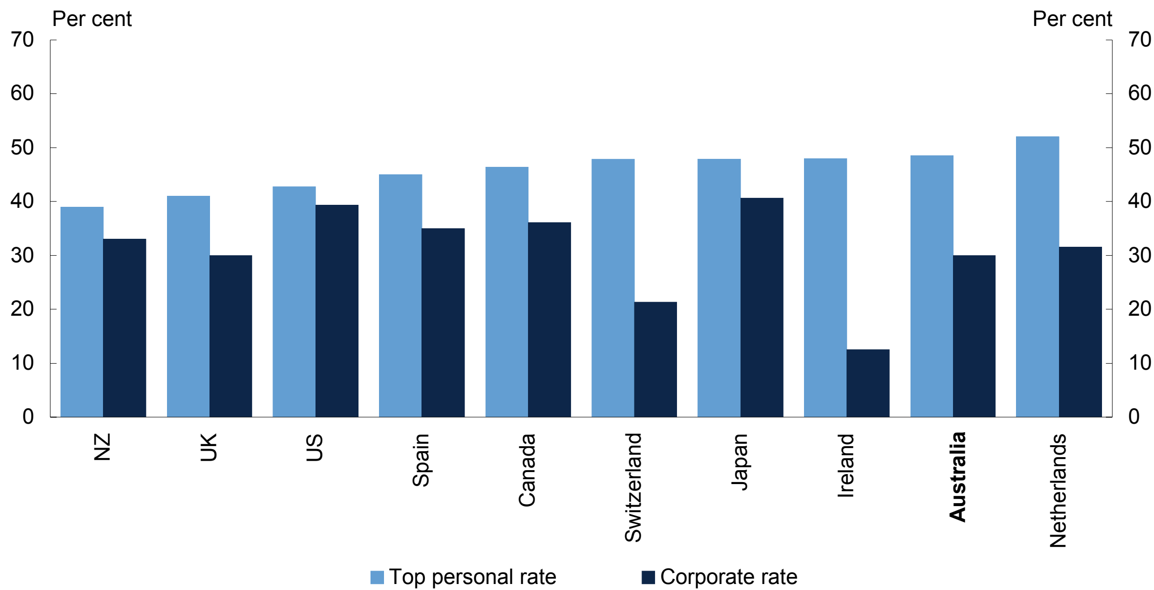
Many of the OECD-10 countries provide exemptions for different types of interest income. For example, the United States provides an exemption for interest earned on bonds issued by US states and municipalities for qualified purposes; Ireland provides an exemption for interest earned on savings certificates issued by the Minister for Finance; the United Kingdom provides an exemption for interest earned in certain qualified savings accounts; and Japan provides an exemption for interest accrued from current bank deposits.

6.6 TOP PERSONAL TAX RATE MEASURED AGAINST CORPORATE TAX RATE

Chart 6.5 illustrates the top marginal personal tax rate for the OECD-10 against the corporate tax rate. None of the OECD-10 have aligned their top marginal personal tax rate with the full statutory corporate tax rate, and all have their top marginal personal tax rate above the full statutory corporate tax rate.

It is important to remember that this is purely a comparison of the marginal tax rate. It is difficult to compare the tax burden as the two systems differ markedly in their tax base and credit system. Further, different rates can apply to corporate income depending on the size of the company and the industry in which it operates.

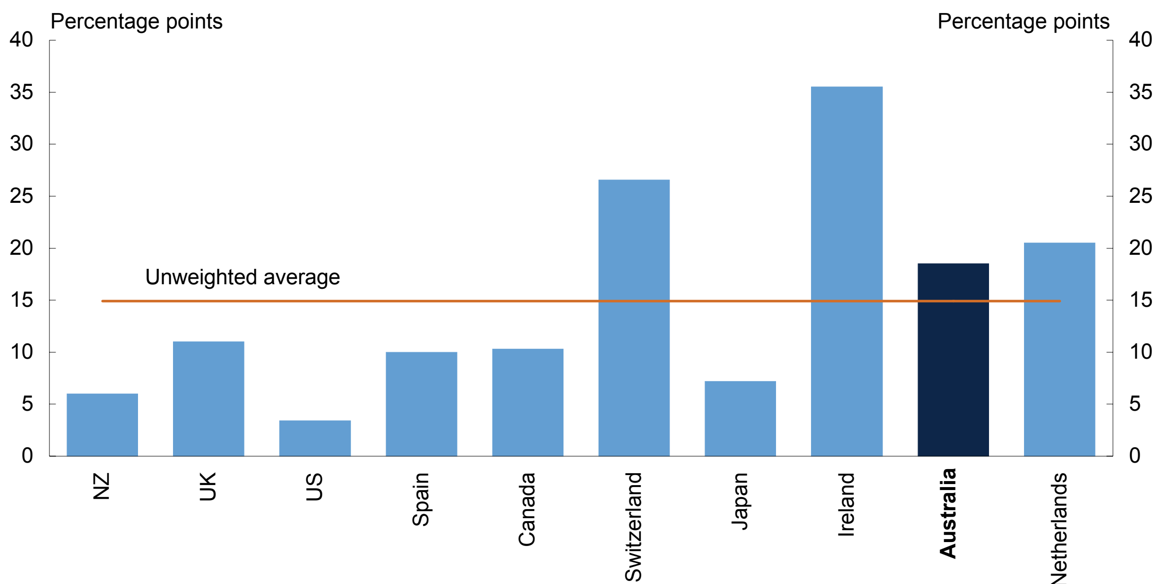
Chart 6.5: Top marginal personal tax rate and full statutory corporate tax rate
OECD-10, 2005



Source: OECD Tax Database (preliminary data); KPMG (various); Deloitte (2006); various country websites.

Chart 6.6 shows the difference between the top marginal personal tax rate and the full statutory corporate tax rate for the OECD-10. Australia has the fourth largest difference (18.5 percentage points) and is around four percentage points above the average (14.9 percentage points) of the OECD-10. The United States has the smallest difference (3.4 percentage points), while Ireland has the largest difference (35.5 percentage points), (see Box 11.1).

Chart 6.6: Difference between top marginal personal tax rate and full statutory corporate tax rate
OECD-10, 2005



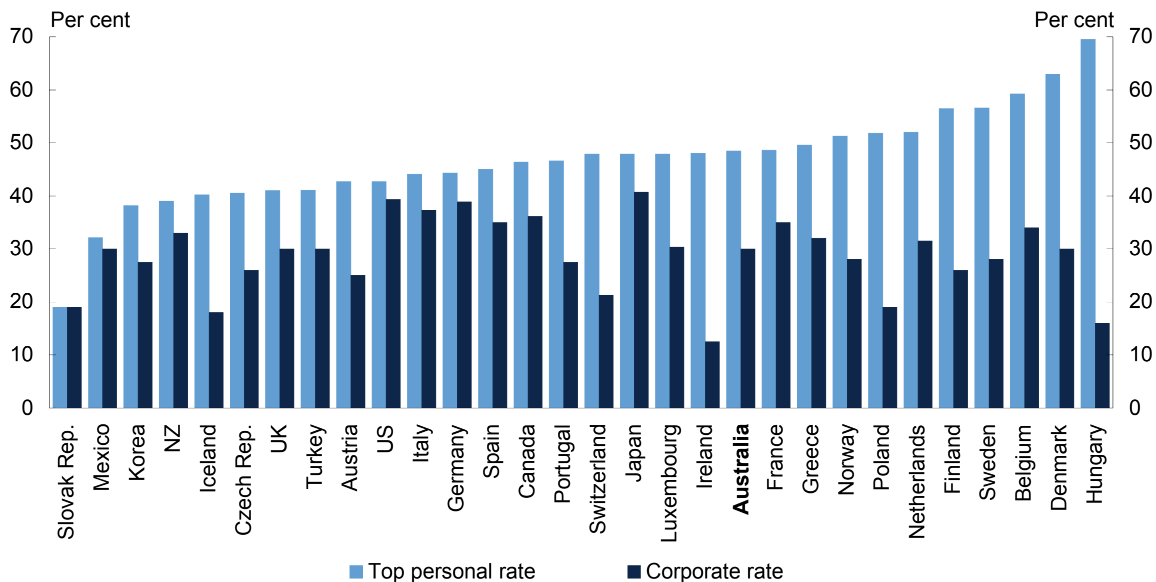
Source: OECD Tax Database (preliminary data); KPMG (various); Deloitte (2006); various country websites.

Chart 6.7 illustrates the top marginal personal tax rate for the OECD-30 against the full statutory corporate tax rate.

Of the 30 OECD countries only one, the Slovak Republic, has aligned its top marginal personal tax rate and full statutory corporate tax rate, although Norway, which has adopted a schedular taxation arrangement, has aligned its corporate tax rate with the tax rate on personal capital income. With the exception of the Slovak Republic, all OECD countries have their top marginal personal tax rate above the full statutory corporate tax rate.

Chart 6.7: Top marginal personal tax rate and full statutory corporate tax rate

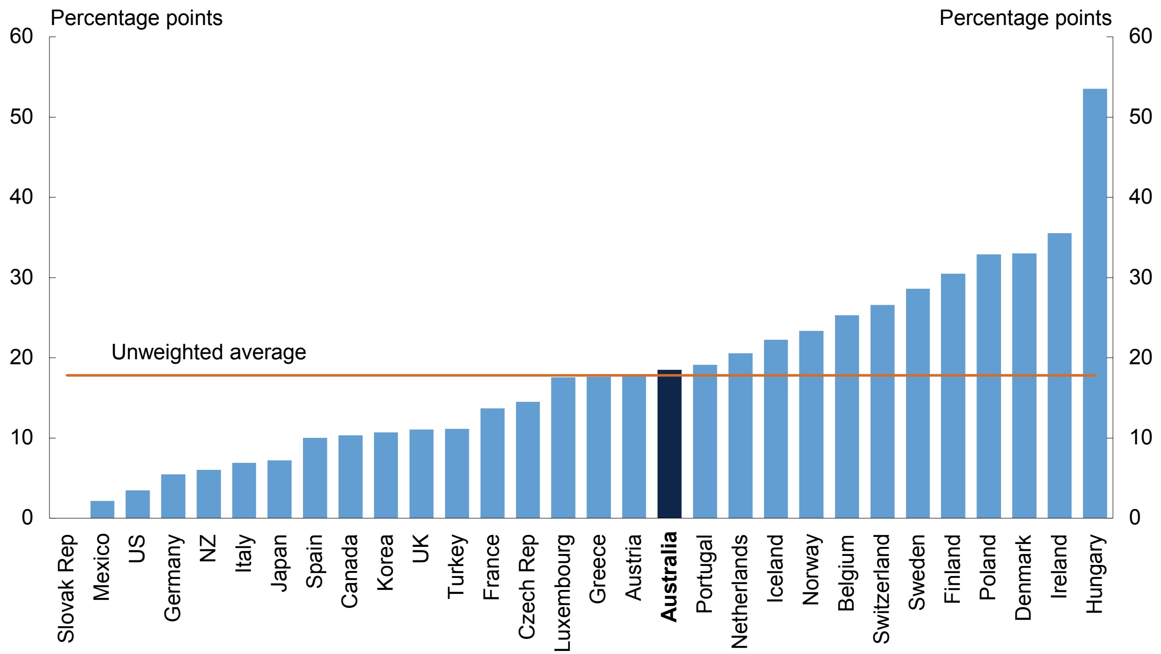
OECD-30, 2005



Source: OECD Tax Database (preliminary data); KPMG (various); Deloitte (2006); various country websites.

As shown in Chart 6.8 the average difference between the top marginal tax rate and the corporate tax rate across the OECD-30 is 17.8 percentage points, only slightly below that of Australia (18.5 per cent).

Chart 6.8: Difference between top marginal personal tax rate and full statutory corporate tax rate
OECD-30, 2005



Source: OECD Tax Database (preliminary data); KPMG (various); Deloitte (2006); various country websites.

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APPENDIX 6.1: INTEGRATION OF COMPANY AND INDIVIDUAL TAXATION

Appendix table 6.1.1: Integration of company and individual taxation — OECD-10

Country	Treatment of domestic tax paid by company, at company level	Treatment at individual resident shareholder level
Australia (Full credit system)	Unfranked dividends paid out of foreign source income cannot generally be franked, which means that imputation credits cannot be attached to the dividends to effectively offset tax payable. At the domestic level, however, franked dividends are grossed up and carry imputation credits. Therefore, currently, there is a disincentive to invest offshore through Australian companies.	Unfranked dividends paid out of foreign source income cannot generally be franked, which means that imputation credits cannot be attached to the dividends to effectively offset tax payable. At the domestic level, however, franked dividends are grossed up and carry imputation credits. Therefore, currently, there is a disincentive to invest offshore through Australian companies.
Canada (Credit system)	There is no specific attaching or tracking of credits. Credits at shareholder level are intended to approximate tax that arises at the company level.	Dividends received from taxable Canadian companies are grossed up by 25 per cent of the dividend and a credit is then given for two-thirds of the grossed up amount (or 13.33 per cent of the gross taxable dividend). This is intended to approximate the amount of tax previously paid by the distributing company. No refund or carry-forward of credits is available. Dividends from the accumulated tax free portion of capital gains may be distributed tax free. This attempts to maintain the tax benefit that would be available on a direct investment.
Ireland (Classical system)	Dividends are exempt from tax in the hands of the recipient. There is neither a withholding tax nor a credit system. No capital gains on individual level.	Dividend withholding tax of 20 per cent applies, subject to a broad range of exemptions.
Japan (Classical/reduced rate)	Dividends received from consolidated (wholly-owned) subsidiaries or affiliated corporations are effectively offset by a 'dividends received' deduction equivalent to 100 per cent of the dividends received. A deduction for only 50 per cent of the dividends received is available when dividends are received from non-affiliated corporations. The dividends received deduction is reduced for interest expenses attributable to the acquisition and holding of shares, other than shares in consolidated subsidiaries. In effect, interest expenses attributable to the acquisition and holding of shares are not deductible for corporate income tax purposes.	Generally, dividends from Japanese corporations are subject to Japanese withholding tax of 20 per cent. However, the withholding tax rate applied to dividends from listed Japanese corporations paid by a Japanese paying agent (securities company or trustee company in Japan) is currently reduced to 10 per cent (the rate of 10 per cent is applicable for dividends paid until 31 March 2008). For dividends paid on or after 1 April 2008, the rate of 20 per cent (including local tax) would be applied where the recipient is an individual who does not own 5 per cent or more of the issued shares of such a listed Japanese corporation. Dividends from unlisted shares and dividends for shareholders who own 5 per cent or more of listed shares are included in taxable income and taxed at progressive rates (maximum of 50 per cent including local tax). In such cases, withholding taxes assessed on dividends are creditable against income tax liabilities. In addition, taxpayers may credit 12.8 per cent (including local tax) on the first ¥10 million of dividends received and 6.4 per cent (including local tax) on any excess as a special dividend credit. Interest on borrowings for the acquisition of shares on which dividends were paid may be deducted from the gross amount of dividends.

Appendix table 6.1.1: Integration of company and individual taxation — OECD-10 (continued)

Country	Treatment of domestic tax paid by company, at company level	Treatment at individual resident shareholder level
Netherlands (Classical/imputed rate)	Dividends distributed to resident shareholders are subject to a withholding tax of 25 per cent (or exempt if participation exemption applies).	Dividends fully taxable to resident individual shareholders at progressive tax rates up to 52 per cent, when the shareholding belongs to the enterprise of the individual. A flat tax rate of 25 per cent applies if the individual owns a substantial interest (5 per cent or more) in the distributing company. An annual net rate of 1.2 per cent on the value of the shares, where applicable related debt(s) may be offset against the value, applies if the shares held by the individual resident are characterised as regular personal assets and not as business assets or part of a substantial interest. This imputed return method applies irrespective of the income realised on the shares. Withholding tax levied on distributions is creditable against tax payable. Excess withholding tax is refundable.
New Zealand (Credit system)	In broad terms, imputation credits arise for company tax paid and for imputation credits attached to dividends received by the company (such as standard imputation credits and credits for foreign dividend withholding which is payable at the time a foreign source dividend is received). A 'top up' withholding tax is levied if dividends paid to resident individuals are not fully imputed.	Taxable dividends are grossed up to include credits attached. Credits may be used to offset the taxpayer's tax liability. Excess imputation credits are non-refundable and are carried forward by individual shareholders and converted to losses in the case of trustee or corporate shareholders. Other credits (for example in respect of foreign dividend withholding tax) and the 'top up' withholding tax are refundable.
Spain (Credit system)	When a company's income includes dividends from Spanish resident companies, 50 per cent will be deducted from the gross tax due corresponding to the dividends. The tax credit is 100 per cent when the dividends come from entities in which the interest is at least 5 per cent owned uninterruptedly in the year prior to the distribution date. Withholding on dividends applied when the tax credit is 50 per cent. No withholding when the tax credit is 100 per cent.	Dividends to resident individual shareholders are taxable, depending on the tax rate of the personal circumstances of the shareholder.
Switzerland (Classical/reduced rate)	There is no integration relief with regard to domestic tax paid at company level.	Basically, dividends received are taxable as ordinary income. Some cantons such as Appenzell Innerrhoden, Obwalden, Nidwalden, Lucerne and Schaffhausen provide a reduced tax rate for income deriving from a substantial participation in a resident company.
United Kingdom (Credit)	United Kingdom resident companies pay corporation tax by reference to their corporation tax self-assessment tax returns. Large companies are required to pay corporation tax by means of quarterly instalments where the first instalment is due 6 months and 13 days after the start of the accounting period. Smaller companies pay tax 9 months and 1 day after the end of the relevant accounting period.	Dividends paid by the United Kingdom resident companies are paid with a 10 per cent non-refundable tax credit. No withholding tax applies to dividends paid from a United Kingdom tax resident company. The United Kingdom tax resident individual shareholder is then taxed on the grossed up dividend (being the dividend received multiplied by 100 over 90) at either 32.5 per cent (less the 10 per cent notional tax credit, giving an effective rate of 25 per cent) or 10 per cent (less the 10 per cent notional credit, resulting in no further liability) depending on the individual's level of total income.
United States (Reduced rate)	No credits for tax paid at the company level can be imputed to shareholders. No domestic withholding tax on dividends paid.	Qualifying dividends taxed at the same rate as long-term capital gains (currently 15 per cent — see note). Other dividends fully taxable to resident individual shareholders at marginal rates. Note: Under current law, the preferential rate of qualifying dividends ends for years beginning in 2009.

Source: various, see Chapter 1 (1.4.1).

APPENDIX 6.2: TAXATION OF CAPITAL GAINS

Appendix table 6.2.1: Taxation of capital gains — OECD-10

Country	Treatment of gains	Capital losses	Rollover relief
Australia Personal income tax Separate taxation No capital gains allowance	**Shares** For shares held less than one year capital gain is included in assessable income, and for shares held more than one year a discounted capital gain (50 per cent) is included. Taxed at marginal tax rate. **Corporate bonds** Same treatment as shares. **Principal residence** Exempt (partial capital gains inclusion to the extent used for business or rent). **Business assets** Non-depreciable assets held greater than one year receive a 50 per cent discount and are included in assessable income. There are also four small business concessions: total exemption for gains on small business assets held for at least 15 years if taxpayer is at least 55 years old and retiring, or permanently incapacitated; the 50 per cent active asset reduction which provides a 50 per cent reduction of a capital gain; retirement exemption (A$500,000 lifetime limit) available for gains on small business assets; small business rollover which provides a deferral of a capital gain if a replacement asset is acquired. Depreciable assets are included in business income and taxed at marginal (personal) rates. Gains or losses resulting from the sale of such assets (depreciation recapture) are taxed at marginal (personal) rates. Building depreciation is the exception to the above recapture and reduces the cost base of the land/building with the subsequent gain or loss on disposal treated as a capital gain or capital loss.	Capital losses on collectables can only be deductible from capital gains on collectables. No capital losses on personal use assets. Losses other than capital losses cannot be deducted against capital gains. Capital losses may be carried forwards indefinitely but cannot be carried backwards.	**Same asset rollover** Rollover relief is available on asset transfer between spouses in the event of a marriage breakdown. **Replacement asset rollover** Rollover relief is available for the exchange of shares in an original company for shares in the new company in the event of a merger or takeover. Rollover relief is available for 'business asset for business asset transactions' for: small business replacement assets; assets compulsorily acquired, lost or destroyed; strata title conversions; scrip for scrip exchanges; and renewal or surrender of statutory licences. Rollover relief is provided where assets of a sole trader (or partnership) business are transferred to a company wholly owned by the sole trader.

Appendix table 6.2.1: Taxation of capital gains — OECD-10 (continued)

Country	Treatment of gains	Capital losses	Rollover relief
Canada Personal income tax Separate taxation Cumulative life-time capital gains allowance of C$500,000 for gains on: (1) qualified small business shares, or (2) qualifying farm property.	**Shares** Half (50 per cent) inclusion in net taxable capital gains and taxed at marginal (personal) rates. **Corporate bonds** Same treatment as shares. **Principal residence** Exempt **Business assets** For depreciable assets, excluding recapture, and non-depreciable assets, half (50 per cent) inclusion in net taxable capital gains and taxed at marginal (personal) rates. Full inclusion in business income of recapture amount is taxed at marginal (personal) rates.	Capital losses on listed personal property are deductible only against capital gains on listed personal property. Fifty per cent of capital losses on shares and/or debt of a qualifying small business corporation can be deductible against capital gains and taxable income from any source ('allowable business investment loss' rules). Ordinary business losses can be deductible against income from any source, including taxable capital gains. Capital losses may be carried forwards indefinitely and carried backwards for three years.	**Same asset rollover** Rollover relief is available on share asset transfer between spouses. **Replacement asset rollover** Rollover relief and deferral is available under certain conditions where proceeds from the sale of a small business corporation are invested in another eligible small business corporation. Rollover relief is available for dispositions of real property held for business purposes, if proceeds are reinvested in replacement property within the specified timeframe. Rollover relief is available for 'business asset for share' exchanges if the taxpayer receives shares, cash or other property, in exchange for business assets.
Ireland Capital gains tax Joint or separate taxation Capital gains allowance of €1,270 against net capital gains.	**Shares** Included in net capital gains and taxed separately at 20 per cent flat rate. Special 40 per cent rate applies to gains on shares deriving their value from certain land developments. **Corporate bonds** Included in net capital gains and taxed separately at 20 per cent flat rate. **Principal residence** Exempt, but gains on residence tied to development of the property are taxed at 20 per cent flat rate. **Business assets** Included in net capital gains, taxed at 20 per cent flat rate. Recapture of depreciation allowances is disregarded unless a loss is incurred (in which case recapture lowers the allowable loss). Exemption of up to €500,000 where business is sold upon retirement of owner (if aged at least 55) and includes gains on land, plant, machinery used in the business if sold at same time and to same person.	Capital gains on certain disposals of development land (subject to separate capital gains tax at 40 per cent rate) are ring-fenced from other capital losses. Otherwise, there is pooling of capital gains and capital losses. Capital losses cannot be deducted against other forms of income or gains. (Capital losses deducted only against capital gains.) Losses other than capital losses cannot be deducted against capital gains. Capital losses may be carried forwards indefinitely and if a capital loss arises in the fiscal year in which a taxpayer dies, the capital loss may be carried back three years (on a LIFO basis).	**Same asset rollover** Rollover relief is available on asset transfer between spouses. **Replacement asset rollover** Rollover relief is available on 'share for share' exchanges in a business reorganisation. Rollover relief is available on transfer of a business to a company in exchange for shares.

Appendix table 6.2.1: Taxation of capital gains — OECD-10 (continued)

Country	Treatment of gains	Capital losses	Rollover relief
Japan Personal income tax Separate taxation Various capital gains allowance depending on type of asset.	**Shares** Unquoted shares are taxed separately at 20 per cent flat rate and quoted shares may be taxed separately at 20 per cent flat rate (special tax rate of 7 per cent, to 2007) or withholding at 1.05 per cent flat rate applied to gross proceeds. **Corporate bonds** Separate taxation at 20 per cent flat rate. **Principal residence** If held greater than ten years, first ¥60 million gain taxed at 10 per cent flat rate and the excess taxed at 15 per cent flat rate. If held greater than five years (but less than ten), separate taxation at 20 per cent flat rate on gains not greater than ¥40 million, 25 per cent rate for gains in excess of ¥40 million.	There is separate pooling of capital gains and capital losses on securities (taxed separately at flat rate), real property held 'short and long-term', and other assets. Capital losses cannot be deducted against other forms of income or gains, except capital losses on the sale of residential property may be deducted from total income of next three years (limited to years in which total income is not greater than ¥30 million) under certain conditions. Non-capital losses may be set off against net capital gains on assets other than securities and real property. Capital losses cannot be carried forwards or backwards on securities, land or buildings, but in certain cases may be carried forwards on quoted shares to offset gains on quoted shares.	**Replacement asset rollover** Rollover relief is available on 'share for share' exchanges, for corporate acquisitions, if shares of acquiring company are recorded at the same book value as shares of acquired company given in exchange. Rollover relief is available on 'business asset for business asset' transactions, for exchange of land, buildings, machinery and equipment, ships, owned not less than one year, in return for similar asset held by other person not less than one year.
Netherlands Personal income tax Separate taxation No capital gains allowance	**Shares** Exempt, except for a 25 per cent flat rate on substantial shareholding (direct or indirect ownership of 5 per cent or more of the total issued share capital, or 5 per cent or more of capital of a particular class of shares). **Corporate bonds** Not taxed, except for gains held as part of a substantial shareholding. **Principal residence** Exempt, provided the residence is not used as business asset. **Business assets** Gains from the sale of business property are taxed as business income at marginal (personal) rates.	There are no restrictions on capital losses against capital gains. Capital gains and capital losses can be aggregated on substantial shareholdings (included in Box 2). Capital losses on substantial shareholdings may be deducted against any other income from a substantial shareholding (for example interest, dividends). Twenty-five per cent of excess capital losses on substantial shareholdings may be deducted against tax on employment income. Residual excess capital losses may be carried backwards or forwards. Box 2 investment losses may be deducted against Box 2 capital gains. Capital losses of substantial shareholdings may be carried forwards indefinitely or carried backwards for three years.	**Same asset rollover** Rollover relief is available when business assets are sold to an employee or member of the same partnership. **Replacement asset rollover** Rollover relief is available, under certain conditions, for gains on substantial shareholdings. Rollover relief is available if the proceeds from the sale of a business asset are invested within three years in another business asset. Rollover relief is available on the transfer of a business asset to a corporation in exchange for newly issued shares.

Appendix table 6.2.1: Taxation of capital gains — OECD-10 (continued)

Country	Treatment of gains	Capital losses	Rollover relief
New Zealand Personal income tax Separate taxation No capital gains allowance	**Shares** Not taxed. **Corporate bonds** Accrual taxation at marginal (personal) rates. (Expected gains taxed on accrual basis, while unanticipated gains/losses taxed on realisation.) **Principal residence** Not taxed. **Business assets** Not taxed, except for certain business assets that are held for resale (for example land, personal property acquired with intention of resale). Note: New Zealand does not have a capital gains tax regime but it taxes some income akin to capital gains under the normal income tax provisions.	There are no restrictions on capital losses against capital gains. All corporate bonds are treated equivalently under accrual rules (no separate pooling of capital gains and capital losses). Losses on bonds are fully deductible against current income. Net capital gains taxed as part of personal income may be offset by other losses. Capital losses may be carried forwards indefinitely.	None
Spain Personal income tax Joint or separate taxation No capital gains allowance	**Shares** Shares held less than one year are included in net taxable capital gains and taxed at marginal (personal) rates, and shares held for at least one year are taxed separately at 15 per cent flat rate. **Corporate bonds** Same treatment as shares. **Principal residence** Exempt, if owner is at least 65 years of age. Rollover if proceeds invested in new primary house (partial relief for partial reinvestment). **Business assets** Capital gains/losses realised on business assets are included in ordinary business income, taxed at marginal (personal) rates. Recapture of depreciation with reference to either actual depreciation deductions or minimum depreciation allowances.	Separate treatment of short-term capital gains and capital losses (on securities held less than one year), and long-term capital gains/capital losses. Short-term capital losses may only be set off against short-term capital gains of the same year and long-term capital losses may only be set off against long-term capital gains of the same year. Excess short-term capital losses, after set-off against short-term capital gains, may be deducted against 10 per cent of other net income excluding long-term capital gains. Business losses are deductible against net short-term capital gains and taxed as ordinary income. Unused short-term capital losses may be carried for four years to be set off against short-term capital gains or 10 per cent of other net income excluding long-term capital gains. Unused long-term capital losses may be carried for four years to be set off against long-term capital gains.	**Replacement asset rollover** Rollover relief is available for gains on participation in a qualifying collective investment institution if reinvested in similar participation.

Appendix table 6.2.1: Taxation of capital gains — OECD-10 (continued)

Country	Treatment of gains	Capital losses	Rollover relief
Switzerland Capital gains tax Joint taxation No capital gains allowance	**Shares** Exempt **Corporate bonds** Exempt **Principal residence** Exempt **Business assets** Movable business property is included as ordinary business income, taxed at the marginal (personal) rates. Immovable business property is taxed by certain cantons as extraordinary business income at marginal cantonal (personal) rates. Recapture of depreciation by cantons following monistic system and no recapture by cantons following dualistic system.	No federal capital gains tax on private movable or immovable property (federal tax only on capital gains or losses on business assets). Capital gains tax on private immovable property at the cantonal level. In some cantons, business losses may be set off against capital gains on private immovable property.	**Same asset rollover** Joint taxation is available for spouses. **Replacement asset rollover** Rollover relief is available to 'business asset for business asset' transactions. Rollover relief is available for 'business or business asset for share' exchanges.
United Kingdom Capital gains tax Separate taxation Capital gains allowance of £8,200 (applied against total net taxable capital gains). Note: In the 2006 Budget, the United Kingdom Government announced it would increase the capital gains allowance for individuals and most trustees.	**Shares** Included in total net taxable capital gains taxed at top marginal personal rate on savings income (10 per cent/20 per cent/40 per cent). Total chargeable capital gains for non-business assets equals total taxable capital gains on non-business assets, less taper relief, giving maximum exemption (40 per cent) for non-business assets held more than ten years. **Corporate bonds** Same treatment as shares. **Principal residence** Exempt (subject to conditions). **Business assets** Included in total net taxable capital gains and taxed at top marginal personal rates on saving income (10 per cent/20 per cent/40 per cent). Total chargeable capital gains for business assets equal total taxable capital gains on business assets, less taper relief for business assets. Taper relief provides a maximum exemption of 75 per cent for business assets held longer than two years.	There are generally no restrictions on capital losses against capital gains. Capital gains and capital losses can be aggregated. However, capital losses on disposal to a 'connected person' may be set off only against capital gains on disposal to the same person. Capital losses generally cannot be deducted against other forms of income or gains. However, capital losses on shares in an unlisted trading company may be set off against income of the current tax year or proceeding tax year. Excess income losses (which cannot be set off against income) may be set off against any capital gains, subject to conditions. Capital losses may be carried forwards indefinitely but cannot be carried backwards, except where capital losses arise in year when a taxpayer dies, or in a year where a mineral lease ends.	**Same asset rollover** Rollover relief is available for asset transfers between spouses. **Replacement asset rollover** Rollover relief is available for gains on shares and debentures exchanged under certain reorganisations (including takeovers) to the extent that shares in, or debentures of, the relevant company are received in exchange. Special deferral rule to 'hold-over' gains invested in new shares of qualifying unlisted trading companies. Rollover relief is available for gains on certain business assets (primarily business premises and goodwill) if the proceeds are reinvested in replacement qualifying business assets. Rollover relief is available for gains on incorporation of a business to the extent that consideration comprises shares in the receiving (that is newly incorporated) company.

Appendix table 6.2.1: Taxation of capital gains — OECD-10 (continued)

Country	Treatment of gains	Capital losses	Rollover relief
United States Personal income tax Joint or separate taxation Capital gains exempt amount of US$250,000 (US$500,000 for married persons filing jointly) for gains on principal residence if owned and occupied by taxpayer as principal residence for greater than two years over prior five years.	**Shares** Shares held for not more than one year are included in net short-term capital gains and are taxed at marginal (personal) rates. Shares held longer than one year are included in net long-term capital gains and taxed separately at flat 15 per cent tax rate (currently reduced to 5 per cent for taxpayers with marginal personal rate of 10 per cent or 15 per cent for ordinary tax purposes). **Corporate bonds** Same treatment as shares. **Principal residence** Taxable at marginal (personal) rates. **Business assets** Subject to some exceptions, part of gain/loss measured from depreciable personal property, excluding recapture, is included in net capital gains taxed at lower capital gains tax rate. Subject to some exceptions, the total gain/loss measured from depreciable real property, without recapture, is included in ordinary business income taxed at marginal (personal) rates. Recapture of past depreciation allowances claimed is included in ordinary business income, taxed at marginal (personal) rates.	No restrictions on capital losses against capital gains. Capital gains and capital losses can be aggregated. Excess capital losses on securities held for not more than one year may be set off against net capital gains on securities held longer than one year; excess capital losses on securities held more than one year may be set off against net capital gains on securities held for not more than one year. Excess capital losses (which cannot be setoff against capital gains) of up to US$3,000 may be set off against ordinary income. Losses other than capital losses cannot be deducted against capital gains. Capital losses may be carried forwards indefinitely.	**Same asset rollover** Joint taxation is available for spouses. **Replacement asset rollover** Rollover relief is available for gains on certain small business stock rolled over into purchases of other eligible small business stock. Rollover relief is available for gains on business assets exchanged for like-kind assets. (This rollover relief also applies to gains on real property (land) held for investment purposes, but not to gains on corporate shares/securities.)

Source: various, see Chapter 1 (1.4.1).

Chapter 7

Retirement savings taxation

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7. Retirement savings taxation

Summary

It is not possible to draw an overall conclusion about the relative ranking of the concessionality of the Australian retirement income taxation system owing to the lack of data and to methodological issues with the various studies on this subject.

There is no report by the OECD or other international organisations identified by this study that provides an overall comparison of the concessionality of taxation of retirement savings regimes. This is due, in part, to the lack of relevant revenue statistics data as well as the interaction of taxation and expenditure systems. This chapter therefore focuses on the taxation of private retirement savings.

The examination of the relative concessionality of countries' taxation arrangements for private retirement savings relies on two studies by Whitehouse (1999) and Yoo and de Serres (2004).

Both papers indicate that the Australian retirement savings taxation regime, like those of other countries, is concessional compared to the taxation treatment of other savings (for example, a bank account).

The Yoo and de Serres paper also highlights the extent to which revenue is forgone in delivering these tax concessions. Australia has the fourth largest amount of revenue forgone per unit of contribution in the OECD-10.

The two papers have contradictory results about the effective tax rates facing private pension savings. Whitehouse (1999) indicates that the concession offered by Australia's taxation of retirement savings is the third highest in the OECD-10. In contrast, Yoo and de Serres (2004) indicate that Australia has the second highest effective tax rate applying to private pension savings out of the OECD-10. This contradiction cannot be reconciled because of methodological issues with both papers.

These methodological issues reduce the reliability of their results on the effective tax rates and their usefulness for international comparisons. In particular, Yoo and de Serres (2004) use different bases for determining the tax rate, depending on the taxation regime applied, and Whitehouse (1999) measures concessionality against a benchmark derived from a country's own marginal tax rates.

Whilst there is no standard 'international model' of retirement savings taxation, eight countries out of the OECD-10 use an EET tax model. This group of eight can be further broken down into those who impose tax at normal marginal tax rates and those who offer a more concessional taxation treatment of benefits. The two exceptions to the EET approach are Australia and New Zealand. However a key finding is that the most important point about the overall concessionality of the taxation arrangements is the rate(s) of tax imposed.

When compared with the OECD-10, Australia is broadly mid-range for the generosity of its contribution limitations and provides above average concessions in terms of the availability and taxation treatment of lump sum payments.

7.1 INTRODUCTION

This chapter differs significantly from most of the other chapters in this review because there is no authoritative primary data source upon which to rely. OECD revenue statistics do not capture taxes on retirement savings in a consistent or transparent manner across countries. Rather, depending on the retirement income system used, the tax burden will be spread (at varying rates) across various parts of the direct income tax base. Without separate data it is not possible to examine the ratio of taxes to GDP, the tax mix or any of the other indicators used in other chapters. In any case, an international comparison of the taxation of retirement savings arrangements is problematic as both the structure of retirement income arrangements and the taxation regimes which countries apply to them vary widely.

Box 7.1: The structure of retirement income arrangements

Retirement income arrangements can be defined in different ways. Perhaps the most commonly used typology is the so-called 'three pillar' approach set down by the World Bank. These pillars are described as:

> a publicly managed system with mandatory participation and the limited goal of reducing poverty among the old [the 'first pillar']; a privately managed mandatory savings system [the 'second pillar']; and voluntary savings [the 'third pillar'].

In practice, arrangements can be much more varied than might be implied by describing them as falling within a particular pillar. Arrangements within a pillar can vary as easily as those between pillars. For instance, the OECD notes that safety-net arrangements (which would be a 'first pillar' arrangement) can broadly be of four different types.

Retirement income systems are also generally composed of a mix of various forms of income secured from various pillars. The pillar which is the chief focus of retirement arrangements can vary significantly from country to country. This focus will often impact upon a country's policy in relation to the taxation of private retirement savings.

This chapter does not compare these disparate systems, but focuses on the taxation regimes imposed on private retirement savings vehicles (that is, second and third pillar arrangements which are not government-controlled or managed) through an examination of the concessionality of regimes (this requires consideration of all elements of the taxation regimes, not only a comparison of tax rates applying at particular points). This partial analysis limits the drawing of robust comparisons or conclusions about the taxation of overall retirement savings.

As is the case in relation to other taxes, there are limitations to such comparisons that do not take into account the different contexts in which the taxes are imposed. For example, the different extent to which countries rely on private retirement savings vehicles can reduce the value in making international comparisons. That is, a country that has little reliance on the

use of private retirement savings vehicles as the primary retirement income vehicle (perhaps due to a universal public pension regime paying large benefits) may be able to afford to offer highly concessional tax treatment to them.

Further, any study which focuses purely on the taxation arrangements (that is, the rates and incidences of taxation) ignores the costs incurred in providing concessions to such savings. Retirement income arrangements are also strongly affected by variable factors such as retirement age and life expectancies (which affect the period of time spent in retirement) and indeed broader social constructs including the level of expected individual responsibility for retirement income provision and social or family support structures. This will impact on policy decisions about the appropriate level of taxation of retirement savings (including decisions about tax concessions).

Discussion of the taxation treatment of retirement savings tends to focus on the taxable or tax exempt status (and tax rates) which applies to contributions, earnings and the payment of benefits. However, limiting the discussion to these elements has the potential to be misleading. Keenay and Whitehouse (2003) have noted the importance of avoiding 'comparing the rates and structures of retirement benefits across countries without also considering the effect on older people of systems of personal income tax and social security contributions'. Many countries, including Australia, offer significant personal income tax concessions to retirees (under various qualifying conditions) such that the overall tax burden is significantly less than if the same level of income was derived by a non-retiree. In general, such concessions are not captured in international comparisons of taxation treatment of retirement savings.

Lastly, even where comprehensive studies of international tax treatment are undertaken they generally have to homogenise the regimes they are looking at (for instance, by ignoring particular concessions or the impacts of other sources of income) to allow the drawing of comparisons.

After examining the concessionality of the taxation of private retirement savings, some descriptive comparisons of particular aspects of retirement savings regimes are considered. The limitations which governments apply to the level of contributions to, and benefits flowing from, the retirement savings system are examined, along with the availability and taxation treatment of lump sums.

7.2 APPROACHES TO TAXING RETIREMENT SAVINGS

There are three points at which retirement savings vehicles (much like any other savings vehicle) can be subject to taxation. Taxation can be imposed on:

- contributions (before or after income tax and social security contributions);
- investment income and capital gains derived from contributions; and
- payment of benefits.

Taxation can be imposed (or not) at each of these three points, giving rise to eight theoretical taxation models. Even regimes which impose taxation at the same points can produce

different outcomes as a result of different tax rates, exemptions, credits, other offsets or even government subsidies which may apply.

Box 7.2: Defining different taxation regimes

In academic literature retirement savings taxation regimes are generally described by a three letter name indicating at what point (or points) taxation is imposed. The presence of a 'T' reflects the imposition of taxation. It does not reflect the overall burden of the tax imposed (that is, a system that imposes 1 per cent, 1 per cent and 1 per cent, would be described as TTT, as would a system that imposed 30 per cent, 30 per cent and 30 per cent).

A model that exempts contributions and earnings but taxes benefit payments is referred to as an 'exempt-exempt-taxed' (EET) model or expenditure tax model. The comprehensive income tax model instead taxes contributions and earnings but not benefits. This model is described as a 'taxed-taxed-exempt' (TTE) model.

From a theoretical stand point, a TEE model produces an equivalent retirement income outcome to an EET model (for the same value of 'T'). Similarly, an ETT model produces an equivalent retirement income result to a TTE model. The table below highlights the retirement income equivalence of the TEE/EET and ETT/TTE regimes (as demonstrated by the value of the net pension). In practice, Whitehouse notes that the systems may not have the same effect because of the point at which the tax exemption occurs.

Table 7.1: Theoretical pension taxation regimes

	EET	TEE	TTE	ETT
Contribution	100.00	100.00	100.00	100.00
Tax	-	25.00	18.00	-
Fund	100.00	75.00	82.00	100.00
Net investment return	61.05	45.79	39.60	48.30
Fund at retirement	161.05	120.79	121.60	148.30
Tax on pension	40.26	-	-	26.69
Net pension	120.79	120.79	121.60	121.60
Net present value of tax	25.00	25.00	24.49	24.49

Source: Derived from Whitehouse (1999).
Note: Assumes 10 per cent annual return (nominal), five-year investment term, discount rate of 10 per cent, 25 per cent tax rate for EET/TEE scenarios and 18 per cent for TTE/ETT scenarios.

Table 7.2 outlines in detail the diverse approaches to the taxation of private retirement savings across the OECD.

Out of the OECD-10, eight countries use a form of expenditure tax treatment. This group of eight can be further broken down into those who impose tax at normal marginal tax rates (Canada, the Netherlands, Switzerland and the United States) and those who offer a more concessional taxation treatment of benefits (Ireland, Japan, Spain and the United Kingdom). The two exceptions to the expenditure tax approach are Australia and New Zealand. New Zealand utilises a comprehensive income tax model, whilst Australia imposes tax at each of the three stages (though at concessional rates).

Table 7.2 illustrates that there is no standard 'international model'. Around a quarter of the countries examined by Yoo and de Serres (2004) do not apply an EET model of taxation. Of those countries that do apply a form of expenditure tax model, more than half deviate

from the 'pure' expenditure tax treatment by taxing pensions at a lesser rate than that applying to other income.

Table 7.2: Tax treatment of private pensions in 2003

	Contributions	Fund		Pension payments	
		Income	Value	Annuities	Lump sums
Australia					
individuals	M	7.1%	E	M/PC	PE/16.5%
employers	15%	7.1%	E	M/PC	PE/16.5%
Austria					
individuals	M/PE	E	E	M/PE	M/PE
employers	E	E	E	M	M
Belgium					
individuals	M/PC	E	0.17%	M/PC	10%
employers	E	E	0.17%	M/PC	16.5%
Canada	E	E	E	M	M
Czech Republic					
individuals	M/PE/S	E	E	15%/PE	15%/PE
employers	E/S	E	E	15%/PE	15%/PE
Denmark	E	15%	E	M	40%
Finland	E	E	E	M	M
France	E	E	E	M/PE	M/PE
Germany	E	E	E	M/PE	M
Greece	E	E	E	M	M
Hungary					
individuals	M	E	E	E	E
employers	E	E	E	E	E
Iceland	E	E	E	M	M
Ireland	E	E	E	M/PE	M/PE
Italy	E	12.5%	E	M/PE	M/PE
Japan	E	E	E	M/PE	M/PE
Korea	E	E	E	M/PE	M/PE
Luxembourg					
individuals	E	E	E	M	M/PE
employers	20%	E	E	E	E
Mexico	E/S	E	E	M/PE	M/PE
Netherlands	E	E	E	M	M
New Zealand					
individuals	M	33%	E	E	E
employers	21%	33%	E	E	E
Norway	E	E	E	M	Not allowed
Poland	E	E	E	M	M
Portugal					
individuals	M/PC	E	E	20%/PE	M/PE
employers	E	E	E	20%/PE	M/PE
Slovak Republic	E	E	E	15%	15%
Spain	E	E	E	M	M/PE
Sweden	E	15%	E	M	M
Switzerland	E	E	E	M	M
Turkey	E	E	E	E	5%/PE
United Kingdom	E	E	E	M	M/PE
United States	E	E	E	M	M

Source: Derived from Yoo and de Serres, OECD *Economic Studies*, No. 39, (2004).

Notes:

(1) 'Private pensions' refers to mandatory or voluntarily funded, privately managed, pension schemes.
(2) Tax deductible contributions are subject to a certain limit in most countries.
(3) The effective tax rate on earnings shown for Australia assumes a portfolio of 60 per cent interest-bearing assets and 40 per cent equities.
(4) Where a country's tax regime differentiates between the tax treatment of employer and employee contributions, each has been shown.
(5) E = exempt.
(6) M = taxed at marginal income tax rates.
(7) PC = partial credit.
(8) PE = partial exemption or deduction from taxation.
(9) S = subsidy.

7.3 MEASURING THE CONCESSIONALITY OF THE TAXATION SYSTEM

Retirement savings attract taxation concessions in many countries. There are a number of arguments used to justify the more generous taxation treatment of retirement savings (when compared with other savings vehicles):

- the state should ensure that people maintain a 'reasonable' standard of living in retirement (and the provision of taxation concessions overcomes any short-sightedness on the part of the individual who may otherwise choose to consume immediately rather than save for future consumption);
- the cost of social security benefits is reduced by encouraging individual provision for retirement, particularly where means-tested social security benefits are an important source of retirement income, as in Australia; and
- the favourable taxation treatment increases long-term savings, which has beneficial impacts on the level/stability of capital available for investment (Whitehouse 1999).

Box 7.3: Benchmarking concessionality

There is no consensus on the benchmark to be used to determine whether a particular retirement savings taxation regime is concessional. The methods of calculating tax expenditures vary from country to country.

According to Yoo and de Serres (2004), a savings taxation regime is generally considered concessional if it deviates (favourably) from the 'comprehensive income tax' model. A pure comprehensive income tax regime will see savings made from after-tax money, any earnings subject to income tax, and a tax free withdrawal of assets. A real-world example of the application of a comprehensive income tax model would be the taxation treatment of a bank deposit in Australia: the deposit is made from after-tax money, any earnings (interest) are subject to taxation, and savings are withdrawn tax free.

Whitehouse (1999) argues that the (more generous) expenditure tax model is a more appropriate benchmark than the comprehensive income tax model as it is neutral between immediate consumption and consumption in retirement.

Whitehouse's research indicates that Australia is considered to be concessional against the more generous expenditure tax benchmark (Chart 7.1 illustrates).

There are very few studies comparing the taxation of private retirement savings. The two papers already mentioned are the most recent and often cited papers on this matter. However, there are significant limitations in their approach to determining the concessionality with which countries tax private retirement savings.

Whitehouse has ranked the relative generosity of OECD countries' taxation of pensions (using the effective generosity of expenditure tax treatment and comprehensive income tax treatment as benchmarks). The Whitehouse paper was published in 1999 and there may have been subsequent changes to taxation regimes since then (for instance Whitehouse indicates that Japan was a TET system at the time he was writing; Yoo and de Serres indicate that in 2004 Japan was applying an EET system).

Table 7.3 shows the relative concessionality of the taxation treatment applied by countries compared to the tax regimes that would apply if the country imposed an expenditure tax regime or a comprehensive income tax regime to retirement savings.

Table 7.3: Pensions taxation in practice

More concessional than expenditure tax	Expenditure tax	Between expenditure and comprehensive income tax	Less concessional than comprehensive income tax
Australia	Argentina	Denmark	Belgium
Austria	Canada	Finland	Iceland
Czech Republic	Chile	France	Japan
Hungary	Columbia	Norway	New Zealand
Ireland	Costa Rica	Sweden	
Korea	Germany		
Portugal	Luxenbourg		
United Kingdom	Netherlands		
	Poland		
	Spain		
	Switzerland		
	United States		
	Uruguay		

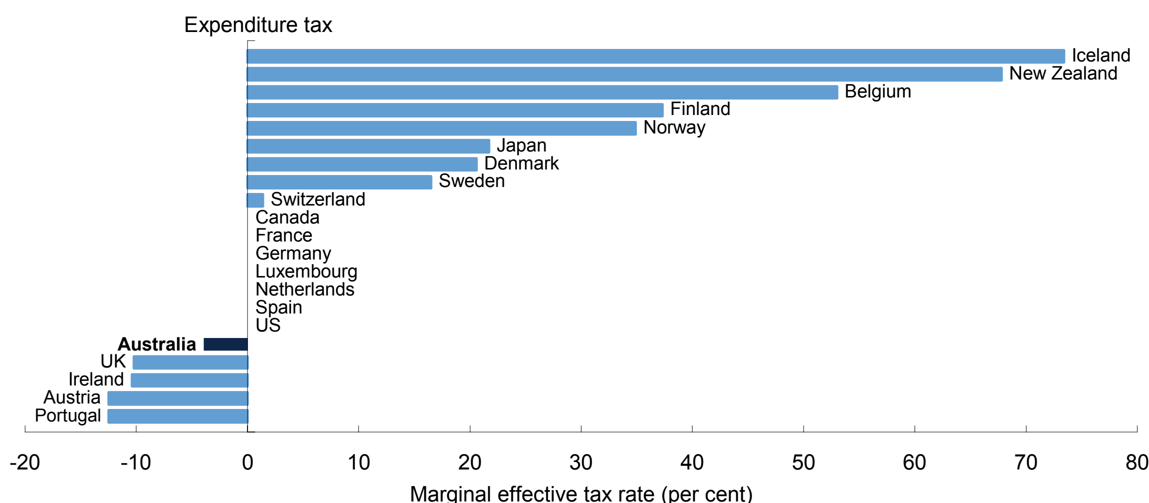
Source: Derived from Whitehouse (1999).
Note: Table shows, from left to right, the most concessional regimes through to the least concessional.

Whitehouse's findings suggest that the points at which taxation is imposed by a country do not necessarily provide an insight into the overall comparative generosity of its taxation treatment of retirement incomes. This is particularly relevant for Australia, given our unique approach to the taxation of superannuation.

Chart 7.1 refines the information presented in Table 7.3 by comparing all countries against an expenditure tax model. The chart indicates the effective marginal tax rate for an average worker's wage (as measured by the OECD), on pension savings (to be read as 'private retirement savings') for 21 OECD countries. Those countries to the left of the 'expenditure tax' axis have a concessional taxation regime compared to an expenditure tax benchmark. In contrast, those to the right tax more heavily than a pure expenditure tax regime. Australia is one of five countries (out of 21) ranked as providing a more generous taxation treatment.

Chart 7.1: Marginal effective tax rates on pension savings

Selected OECD countries, tax rate at average production worker earnings level



Source: Derived from Whitehouse (1999).

In the Whitehouse findings Australia is fifth out of 21 OECD countries in terms of the relative concessionality of the retirement savings taxation regime and third out of the OECD-10. The caveat to these results is that each country is compared against an EET case calculated against its own taxation regime. The figures reflect the difference between a country's retirement savings taxation arrangements and its own marginal tax rates.

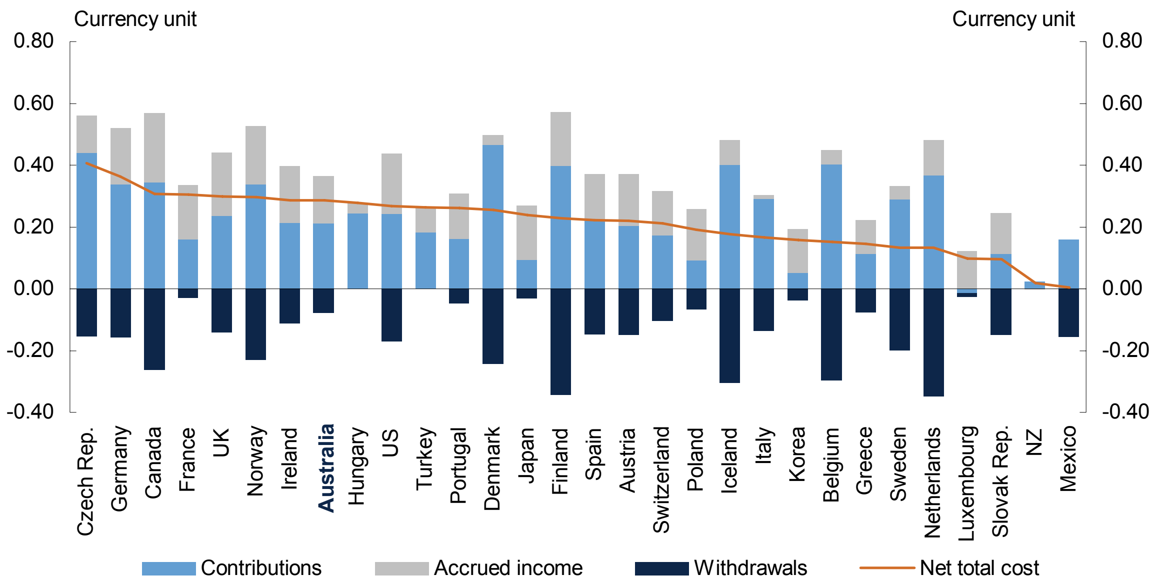
Chart 7.2 illustrates the total revenue cost to countries incurred per unit of contributions (for example, per dollar). According to Yoo and de Serres, Australia is eighth in terms of the revenue forgone per dollar of contributions across the OECD countries and fourth (behind Canada, Ireland and the United Kingdom) when compared against the other OECD-10 countries.

Yoo and de Serres also rank countries on the basis of the effective tax rates on private pensions (and compare this against the effective tax rate on a benchmark savings product). Their results are set out in Chart 7.3. Compared to the OECD-10 comparators, Australia (it is argued) has the second highest effective tax rate on private pension savings.

A further conclusion which might be drawn from Chart 7.3 is the extent of the concession which countries provide to retirement savings in contrast to the taxation treatment of benchmark savings (as measured by the gap between the two bars for each country). On such a measure Australia would be first amongst the OECD-10 and second across the entire OECD.

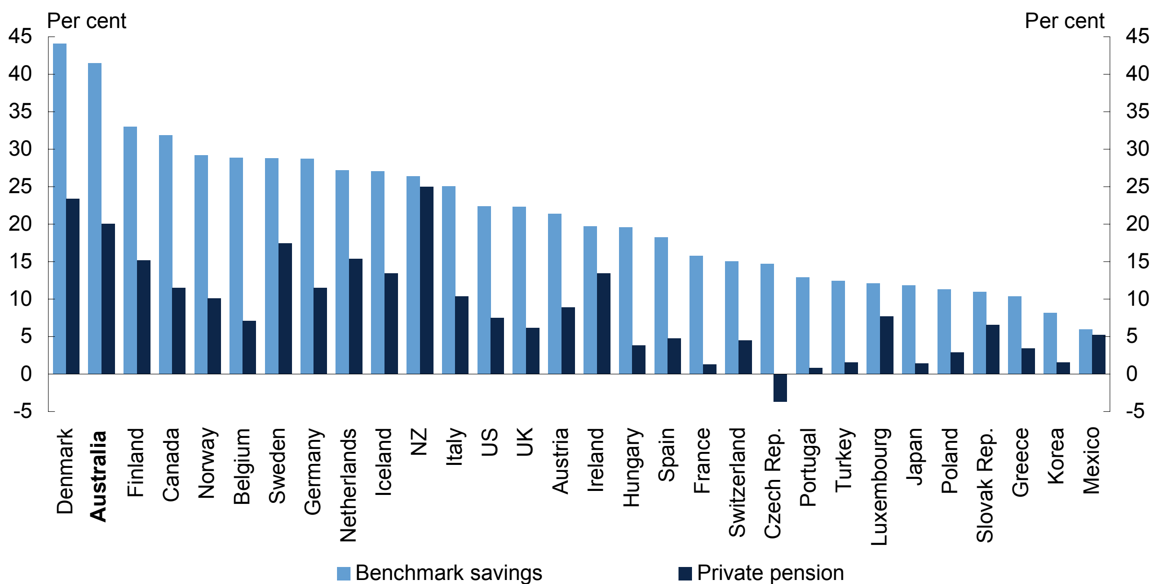
It is important to note that the relative rankings of countries in the Yoo and de Serres study are very sensitive to a number of the assumptions and methodological choices made, as discussed in Box 7.4.

Chart 7.2: Net tax cost per unit of contribution, age group average



Source: Yoo and de Serres (2004).

Chart 7.3: Effective tax rates on private pension and benchmark saving, age-group average



Source: Yoo and de Serres (2004).

Note: Based on the employer-sponsored schemes (except Italy and Korea) and lump sum payments. However, for countries in which tax treatment between the employer's and the employee's contribution is the same, the distinction between employer-sponsored and individual pension schemes is meaningless.

The effective tax rate is measured as the difference between the net present value of the pre-tax and post-tax assets in proportion to the net present value of the pre-tax assets, for 6.5 per cent of return (and discount rate).

Box 7.4: Issues of methodology

Many studies are sensitive to the assumptions underlying their methodology.

In comparing the marginal effective tax rates on pension savings against an expenditure tax (EET) benchmark, Whitehouse relies on the value of 'T' in his benchmark being the same as that faced in working life. However pensioners are unlikely to face the same marginal tax rate in retirement as they did in their working life (particularly given the tax concessions many countries offer to their pensioners and their generally lower income levels).

Yoo and de Serres use different tax bases for different regimes (for example, the tax base for an EET regime is different to that for a TEE regime). These differences in the tax base prevent comparison between different regimes (that is, a TTT regime cannot be effectively compared to an EET regime) though the relativities within regimes are valid.

The Yoo and de Serres paper is also very sensitive to the way in which the present-day value of benefits is determined. The assumption in the paper is that, in today's terms, if a person contributes a dollar, they will withdraw only a dollar at the benefits stage. Changing the way this is calculated does not affect the relativities between EET systems, but has a significant impact on the comparative results for TTE and TTT countries compared against the EET regimes. That is, if the outcome of the contribution is improved (by assuming that a dollar contribution delivers more than a dollar of benefits) the relative standing of the TTE and TTT countries is improved.

Both the Yoo and de Serres methodology and the Whitehouse methodology are also sensitive to assumptions about the tax rate faced in retirement. Both use a simplified treatment (though different between the papers) to deal with the complex arrangements that apply in retirement. As noted previously, this tendency to homogenise taxation regimes is a common feature of international work on retirement savings.

While Australia provides taxation concessions to retirement savings (compared both to a benchmark savings product and to an expenditure tax regime), the data are not available to enable robust cross-country comparisons.

7.4 COMPARATOR TABLES

The treatment of particular aspects of retirement savings arrangements can also inform consideration of the various taxation regimes. Following are comparative tables outlining the limitations which apply to contributions to and benefits from retirement savings vehicles and the availability and tax treatment of lump sum payments.

The information in the tables suggests that Australia's limitations on contributions are broadly in the middle of the OECD-10 and that our taxation treatment of lump sums provides above average concessions (although not much can be drawn from considering the treatment of one point in the contributions/earnings/benefits cycle).

7.4.1 Limits on concessionality

Countries frequently limit the amount of concessionally taxed retirement savings that can be accumulated by an individual. There are two key ways of imposing such limits: contribution limits (a flow limitation) and benefit limits (a stock limitation). The imposition of contribution and benefit limits provides governments with a level of comfort about the level and distribution of the costs associated with providing tax incentives to encourage retirement savings. Contribution and benefit limitations can either be used individually or in combination, dependent in part on how they are applied.

Table 7.4 sets out some high-level international comparisons of the mechanisms used to limit concessionality.

The data in the table might seem to indicate that Australia imposes significant limitations on the amount of concessional benefits which can be received compared to the rest of the OECD-10. However, of the five comparator countries that impose no benefits limits, New Zealand imposes a comprehensive income tax arrangement and the remaining four impose marginal tax rates on end benefits (though in two cases with possible credits or exemptions), thus imposing effective benefits caps if high marginal tax rates in retirement are to be avoided. In addition, the United States and Switzerland also impose strict contribution limits (rather than merely limiting tax deductibility for contributions). This range of treatments provides an example of how different forms of contributions and benefit limitations can be used either individually or in unison to achieve similar outcomes, namely the effective limitation of the level of tax concessions provided.

Table 7.4: International limitations on private pension contributions and benefits

Country	Contribution limits	Benefit limits
Australia	Age-based contribution limits (ABLs) impose a cap on tax deductibility for employers (and eligible self-employed). In 2005-06, the ABL is A$14,603 for those under 35, A$40,560 between 35 and 49 and A$100,587 for those aged 50 and over. Self-employed individuals do not receive the same dollar-for-dollar deduction available to employers. For the self-employed the first A$5,000 is deductible, as is 75 per cent of the remainder of their contributions up to the ABL. Excessive contributions receive no tax deduction and therefore face a higher effective tax rate.	Benefit limitations apply, called Reasonable Benefits Limits (RBLs). In 2005-06, these limits are set at A$1,297,886 for the pension RBL and A$648,946 for the lump sum RBL. The pension RBL is greater to encourage pension uptake and applies if at least 50 per cent of benefits are taken as an income stream (subject to it meeting certain requirements). Excessive benefits are subject to tax at the rate of 38 per cent (where they have already faced the 15 per cent 'contributions' tax).
Canada	Contributions to employer registered pension plans limited to C$19,000 in 2006 (applies to total employer/employee contributions). Contributions to registered retirement savings plans (RRSP) limited to the lesser of 18 per cent of prior year's earnings or C$18,000 (in 2006). Members of employer pension plans face a reduction based on prior year's contributions. Deductions capped at these absolute levels. Unused RRSP contribution limit can be carried forward indefinitely.	Limits apply to Defined Benefit (DB) plans. Pension cannot exceed 2 per cent per year of service multiplied by pensionable earnings (and capped at a maximum of C$2,111.11 per year of service).
Ireland	Age-based contribution limits cap tax deductibility for individuals (as a percentage of net relevant earnings). Salary limit of €254,000 applies.	From 7 December 2005, a benefits limit applies. Maximum allowable balance set at €5 million (transitional rules apply for balances which exceeded this limit as at 7 December). Excessive benefits are subject to tax at the rate of 42 per cent when drawn down.
Japan	Complex limitations apply depending upon whether a person has other corporate pensions and upon their employment status (that is, if self-employed). Monthly contribution limits range from ¥18,000 to ¥68,000.	None
Netherlands	None. Uncapped tax deductibility is available for contributions. Ability to make voluntary contributions may not exist (the company running an employment-based scheme may allow voluntary contributions, but this is not a requirement).	None for accumulation funds, but DB funds limited to pension benefits of 100 per cent of salary.
New Zealand	None	None
Spain	Maximum deductible amount is €8,000 per year for employee and same amount for employer. Taxpayers over 52 get an additional allowance of €1,250 with a maximum limit of €24,250 for members aged 65 and over. Some capacity to carry forward deductibility (for up to five years).	None
Switzerland	All contributions deductible except for certain third-pillar contributions which receive only a minimal deduction.	None
United Kingdom	Tax deduction contribution cap applies. From 6 April 2006, deduction limited to greater of 100 per cent of person's United Kingdom earnings or £3,600. If an employer contributes more than £215,000 for a person in a year, then the excess is taxed at 40 per cent.	From 6 April 2006 lifetime allowance (LTA) limits concessional benefits to £1.5 million (for the 2006-07 United Kingdom financial year). Any excessive benefits taxed at a rate of 55 per cent if taken as a lump sum or at 25 per cent if taken as an income stream.

Table 7.4: International limitations on private pension contributions and benefits (continued)

Country	Contribution limits	Benefit limits
United States	Strict contribution limits apply to contributions to individual retirement accounts (IRAs). In 2005 contributions were capped at US$4,000 (US$4,500 for those aged 50 and above). Whilst there is some ability to offset excess contributions against unused limits in future years, penalties and additional tax can apply. Strict contribution limits also apply to 401(k) plans. In 2005 contributions were capped at US$14,000 worth of deferred income. People aged 50 and above can make additional contributions of US$4,000.	None

Source: Various, see Chapter 1 (1.4.1).

7.4.2 Availability and tax treatment of lump sums

Table 7.5 provides a summary of international arrangements concerning access to lump sums from private savings (a relatively common payment type in Australia). The table also notes any limitations which apply to lump sums and details of the relevant taxation treatment.

An examination of the treatment of lump sums is relevant given the tendency of Australian retirees to take their benefits in this way. Additionally, a comparison of pensions is less useful as it is not possible to review comprehensively the range of tax concessions that other countries offer to their retirees. In any event, pension income tends to be taxed at marginal rates.

Table 7.5: International practice — lump sums from private retirement savings vehicles

Country	Taxation arrangements
Australia	Tax rates on lump sums vary based on the constituent components. They may contain up to eight different components taxed in seven different ways. The first A$129,751 (2005-06 value) of the most common component (that is, post-June 1983 taxed element) faces a zero per cent tax rate.
Canada	Lump sum is taxed at marginal rates.
Ireland	Lump sum only available when assets in a personal retirement savings plan first become available to the contributor. Lump sum is limited to a maximum of 25 per cent of the value of the benefit. Lump sum is received tax free.
Japan	Lump sum is 50 per cent taxable at marginal rates.
Netherlands	Lump sum payments no longer available.
New Zealand	Lump sum generally received tax free, but certain employer contributions attract a five per cent fund withdrawal tax on distribution to fund member.
Spain	Lump sum is taxed as employment income. 40 per cent tax reduction available if at least two years elapsed since first contribution.
Switzerland	Lump sums only available for voluntary additional savings. Pensions payable in all other circumstances. Subject to preferential rate which varies but roughly amounts to one third of individual's rate.
United Kingdom	From 6 April 2006 lump sums are restricted to the lesser of 25 per cent of the value of the benefit and 25 per cent of unused lifetime allowance. Lump sum is received tax free.
United States	Taxed at marginal rates.

Source: Various, see Chapter 1 (1.4.1).
Note: Table assumes access at normal point of retirement/access. Different (less generous) tax regimes tend to apply to early access.

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Chapter 8

Taxation of goods and services

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8. TAXATION OF GOODS AND SERVICES

SUMMARY

Over the past fifty years, OECD countries have generally become more reliant on taxes on general consumption as a proportion of total taxation revenue, but there has been a decline in revenue from taxes on specific goods and services. The key reason for this is the substitution of value added taxes (VATs) for other specific consumption taxes.

Australia's revenues from both general and specific goods and services taxes (9.4 per cent of GDP) are around the average of the OECD-10 (9.2 per cent) — Australia is fifth lowest in terms of tax burden.

The mix of Australia's goods and services taxes differs from the average OECD-10 mix, mainly through lesser reliance on value added and sales taxes.

Australia's revenues from value added and sales taxes are the fourth lowest of the OECD-10 at 4.3 per cent of GDP and are below the unweighted average of OECD-10 (5.5 per cent).

Australia has the equal fourth lowest statutory tax rate on general consumption of the OECD-30 and its 10 per cent goods and services tax (GST) rate is well below the unweighted OECD average of 17.6 per cent.

Of the twenty-nine OECD countries which levy a value added tax (VAT), twenty-seven, including Australia, apply reduced rates and/or zero rates to certain goods and services. Thirteen OECD countries do not apply a zero rate to any domestic goods or services (as at 1 January 2003).

Australia's reliance on excise and customs duties is 3.4 per cent of GDP. It is the third highest in the OECD-10 and is higher than the average of the OECD-10 countries (2.6 per cent).

Australia's rates of fuel excise duty are among the lowest in the OECD. As at 1 January 2005, Australia had the fourth lowest tax rate on unleaded petrol of both the OECD-30 and the OECD-10.

For the last quarter of 2005, the average level of tax (both GST and excise duty) included in unleaded petrol prices in Australia was A$0.490 per litre — this was less than half the OECD-30 average (A$1.148 per litre). Australia had the third lowest level of tax included in unleaded petrol prices of both the OECD-30 and the OECD-10.

The diversity across countries in the implementation of excise duties applied to alcohol and tobacco products makes it difficult to determine Australia's relative ranking compared to other countries for these products.

Disaggregation of recurrent indirect taxes into sub-components is problematic. Significant classification issues exist in the data. Subject to these caveats, Australia has the equal highest

tax burden of the OECD-10 countries from motor vehicles tax (0.6 per cent of GDP) — this is well above the average of the OECD-10 countries of 0.3 per cent of GDP.

Based on 2001 data, for both the OECD-30 and the OECD-10, about half of countries do impose specific environmental taxes and half do not.

8.1 INTRODUCTION

This chapter provides an overview of goods and services taxes as a proportion of GDP. As in other chapters, the focus is generally on the OECD-10 comparator group, and supplements the information in Chapter 3.

The chapter then examines the base and rates for different parts of the goods and services taxes classification. The primary division is between general taxes (such as a VAT or GST) and specific taxes on goods and services. The chapter draws out differences in the rate and base of general consumption taxes.

Taxes on goods and services cover all taxes and duties levied on the production, extraction, sale, transfer, leasing or transfer of goods, and the provision of services, or taxes and duties levied in respect of the use of goods or permission to use goods or perform activities.

This category covers taxes such as:

- general sales taxes;
- value added taxes (such as Australia's goods and services tax — GST);
- excise duties;
- tax levied on the import and export of goods; and
- taxes levied in respect of the use of goods and taxes on permission to use goods, or perform certain activities.

Specific goods and services taxes are broken into several different classifications. As is the case throughout this report, when the aggregate information is broken down further, classification errors arise. Differences in tax structures in countries can also make international comparisons of the more detailed break-downs problematic. Several specific examples of this are outlined below.

Analysis of specific goods and services taxes is complicated by their broad range and interactions. Comprehensive and comparable information could not be found for all OECD-10 countries. Additionally, as these types of taxes are often levied by sub-national and local governments, there are potentially hundreds or even thousands of combinations. The discipline of international comparisons across a consistent set of countries is a useful approach, and further study would be useful for further international tax analysis (whether by private bodies or by government).

As most specific goods and services taxes are imposed at a flat, proportionate rate, tools of analysis such as average versus marginal analysis are less relevant to them. There are also

few tools equivalent to the effective average and marginal tax rate measures used in the corporate taxation chapter. As a consequence, most of the analysis in this chapter is based around descriptive measurements of variations in rates and tax bases.

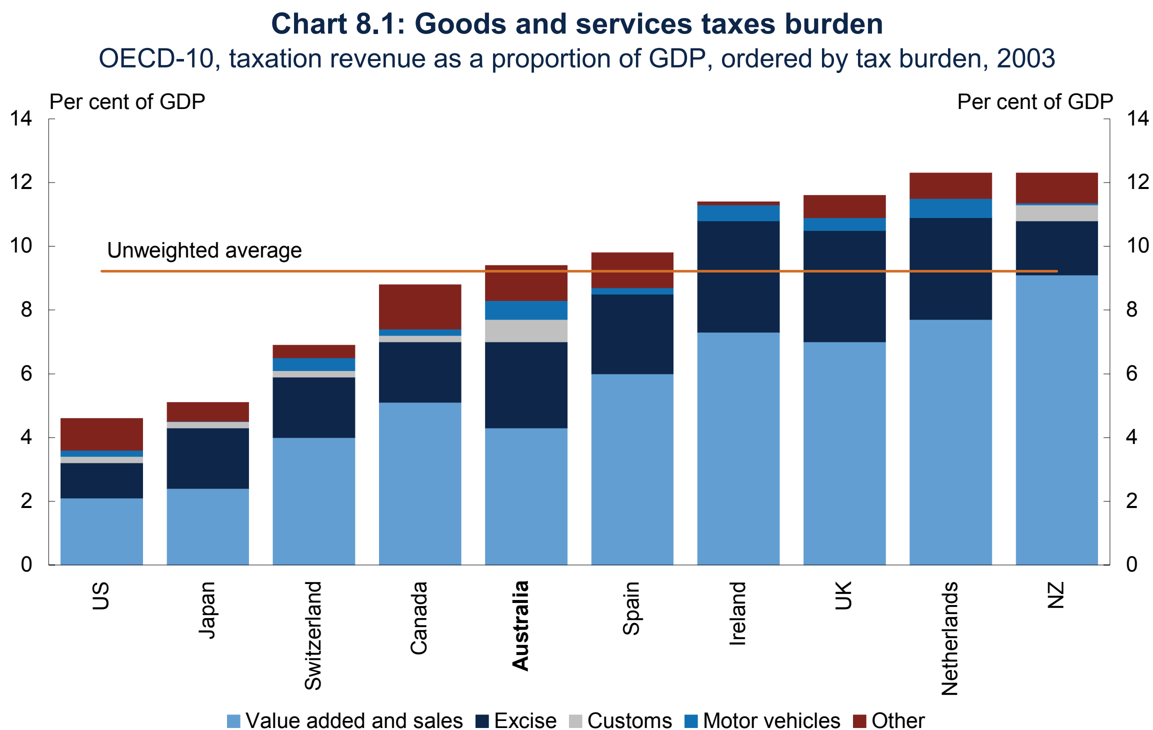
8.2 Broad international comparisons

Australia's revenues from both general and specific goods and services taxes (9.4 per cent of GDP) are around the average of the OECD-10 (9.2 per cent) — Australia ranks fifth lowest in terms of tax burden.

New Zealand (12.3 per cent), the Netherlands (12.3 per cent), the United Kingdom (11.6 per cent) and Ireland (11.4 per cent) all have a relatively high reliance on goods and services taxes.

Chart 8.1: Goods and services taxes burden

OECD-10, taxation revenue as a proportion of GDP, ordered by tax burden, 2003

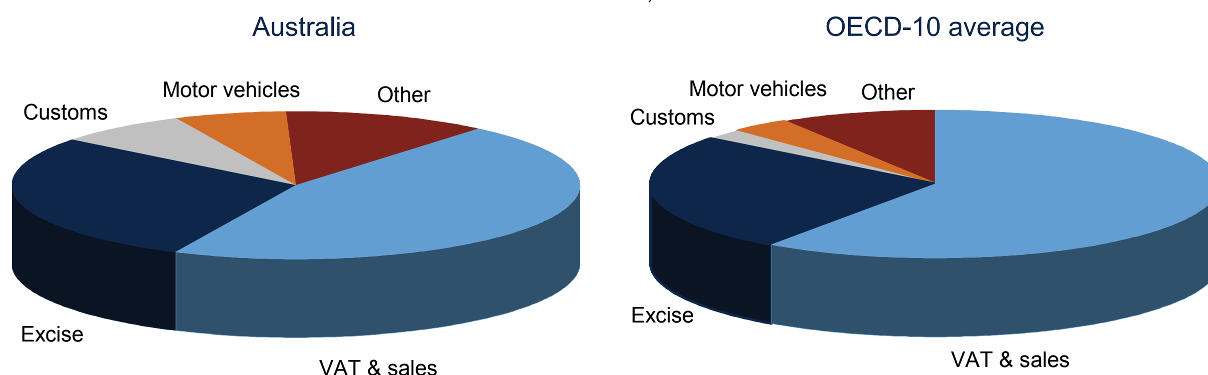


Source: OECD *Revenue Statistics*, 2005.

The mix of Australia's goods and services taxes has some marked differences from the average OECD-10 mix, mainly as a result of Australia's lesser reliance on value added and sales taxes.

Chart 8.2: Australia's goods and services tax mix

OECD-10, 2003

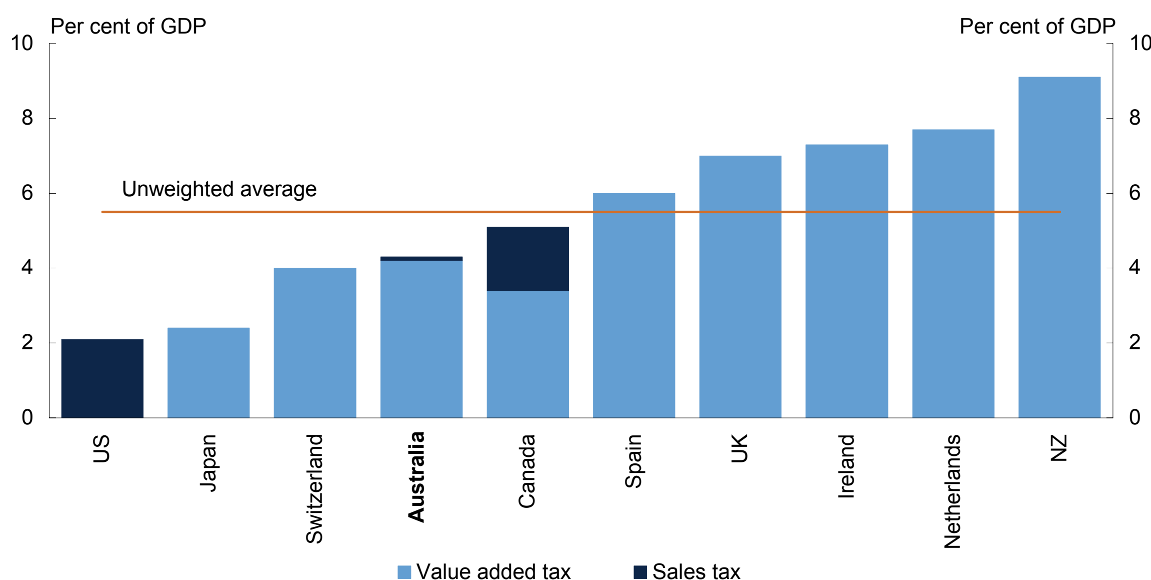


Source: OECD *Revenue Statistics*, 2005.

When compared with the OECD-30, Australia has a relatively low tax burden from value added and sales taxes (4.3 per cent of GDP) — of the OECD-10, Australia is fourth lowest in terms of tax burden. This is lower than the average of the OECD-10 of 5.5 per cent.

Chart 8.3: Value added and sales tax burden

OECD-10, taxation revenue as a proportion of GDP, ordered by tax burden, 2003



Source: OECD *Revenue Statistics*, 2005.
Note: Australia levies two taxes which are classified as sales taxes — luxury car tax (LCT) and wine equalisation tax (WET). LCT was implemented on 1 July 2000 to prevent disproportionate falls in the price of luxury vehicles compared to standard model vehicles when the GST rate of 10 per cent replaced the previous wholesale sales tax (WST) rate of 45 per cent. LCT applies on vehicles at a rate of 25 per cent for every dollar over the luxury car threshold (currently A$57,009) and only applies to cars at the retail level. WET was also introduced on 1 July 2000 to offset the removal of the previous 41 per cent WST rate on wine and the introduction of the 10 per cent GST. WET is calculated at 29 per cent of the final wholesale price (that is, a smaller base than the LCT which is the retail price). In certain permitted circumstances for the WET, a nominal wholesale price is calculated as 50 per cent of the retail price, or alternatively at the average wholesale price for identical wine.

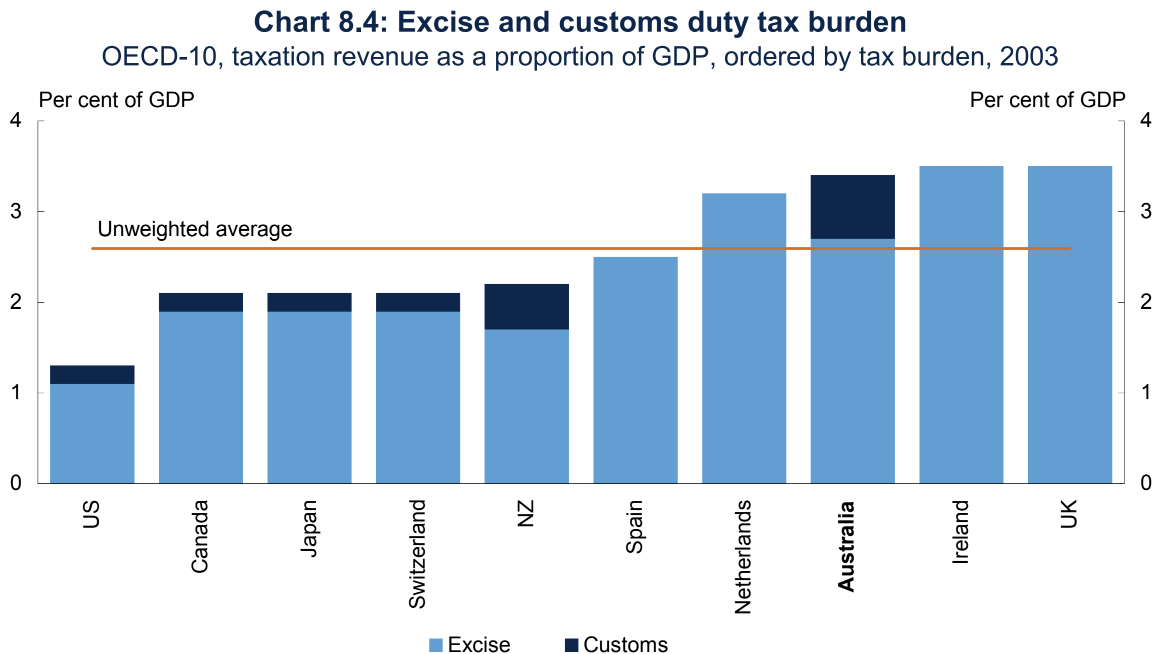
Australia's reliance on excise and customs duties at 3.4 per cent of GDP is the third highest in the OECD-10 and compares with the average of the OECD-10 countries of 2.6 per cent.

Only the United Kingdom (3.5 per cent) and Ireland (3.5 per cent) have slightly higher tax burdens from excise and customs duties.

As discussed in Chapter 3, there are classification issues with customs duty which means that care needs to be taken in drawing conclusions from the disaggregated excise and customs duty data.

Chart 8.4: Excise and customs duty tax burden

OECD-10, taxation revenue as a proportion of GDP, ordered by tax burden, 2003

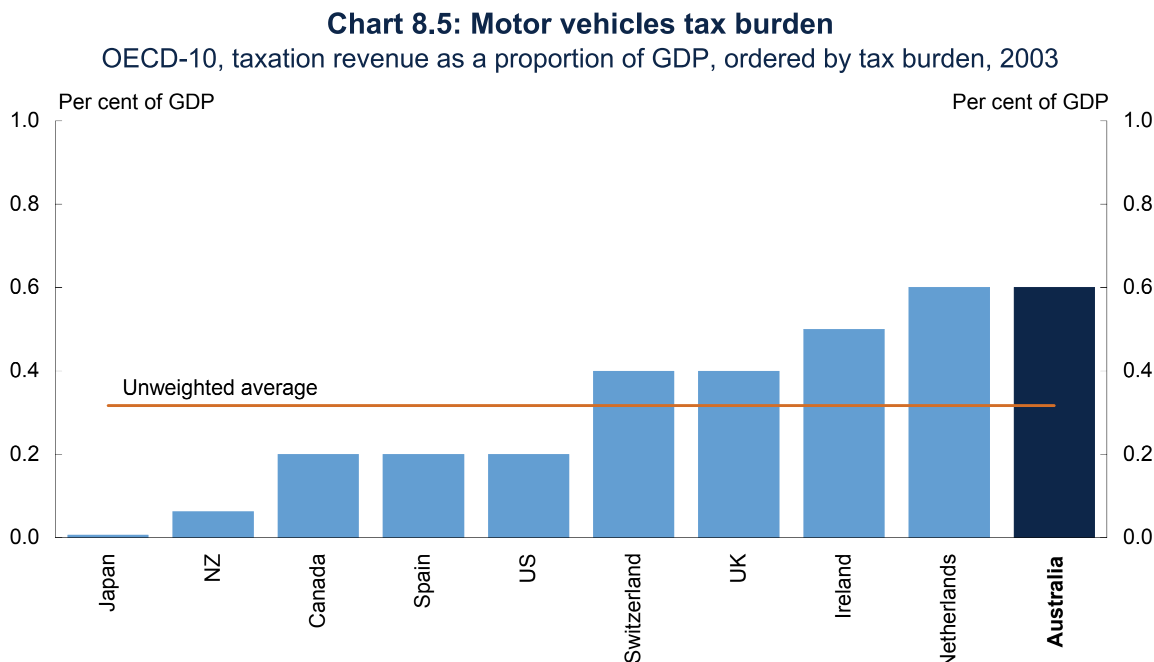


Source: OECD *Revenue Statistics*, 2005.

Disaggregation of recurrent indirect taxes into sub-components is problematic. Significant classification issues exist in the data. Subject to these caveats, Australia has the equal highest tax burden of the OECD-10 countries from motor vehicles tax (0.6 per cent of GDP) — this is well above the average of the OECD-10 countries of 0.3 per cent of GDP. The Netherlands also has a tax burden of 0.6 per cent.

Chart 8.5: Motor vehicles tax burden

OECD-10, taxation revenue as a proportion of GDP, ordered by tax burden, 2003



Source: OECD *Revenue Statistics*, 2005.

Motor vehicle taxes cover taxes levied on the use of motor vehicles — recurring charges levied on the right to drive on public roads, usually in the form of annual vehicle licence taxes/registration fees.

Recurring taxes on motor vehicles can take many forms. These taxes are usually assessed with respect to weight, usage and vehicle type, or type of fuel used and engine size.

8.3 VALUE ADDED AND SALES TAXES

The two main forms of general consumption tax in use in OECD countries today are the value added tax (VAT) and the sales tax.

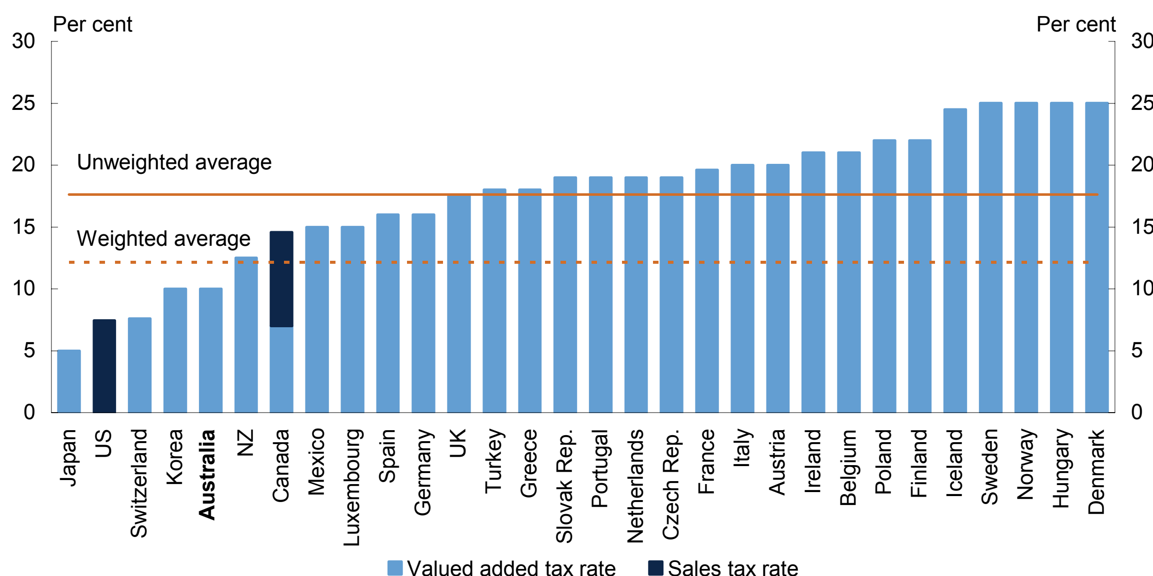
Twenty-nine out of the thirty OECD countries levy a VAT. This includes Australia's GST.

The United States is the only OECD country that does not have a VAT. Most US states levy retail sales taxes. In addition, local municipalities also levy sales taxes in the majority of states.

In Canada, the federal government levies a GST, while most Canadian provinces either levy additional sales taxes on certain goods and services or have integrated their sales taxes with the federal GST.

Chart 8.6 shows the tax rates of these general consumption taxes for the OECD-30. The tax bases of VATs and sales taxes can vary significantly, as can their implementation and design. Combining VAT rates and sales tax rates only gives a broad comparison of the actual tax rates applying generally to consumption.

Chart 8.6: Value added and sales tax rates
OECD-30, 2005



Sources: OECD Tax Database; Federation of Tax Administrators website; PricewaterhouseCoopers (2005).
Notes: The VAT rates shown are the standard VAT rates for 2005. As state and local sales tax rates for 2005 were not available, the rate shown for the United States is an average of the maximum combined state and local rates as at 1 July 2004 (7.4 per cent). As at 1 July 2004, maximum combined rates varied across the US States from 4 per cent to 11.5 per cent. The sales tax rate for Canada is an average of the provincial sales tax rates (7.8 per cent). Provincial sales tax rates in Canada range from 7 per cent to 10 per cent.

Australia's GST rate of 10 per cent is significantly below the unweighted OECD average of 17.6 per cent and is the equal fourth lowest rate of the OECD-30. Australia's GST rate is also the fourth lowest of the OECD-10.

8.3.1 Value added taxes

A VAT is a broad-based consumption tax, which is levied on the consumption of both goods and services.

VAT systems differ around the world for a variety of reasons, but follow the basic principle of taxing a broad base of goods and services, and allowing businesses to offset the VAT paid on their inputs against their VAT liability. This results in VAT only being collected on the value added by each business in the production and distribution chain, with VAT being ultimately paid by the final consumer. Another central feature of VAT systems is a zero VAT rate[1] applying to exported goods and services.

In the past fifty years, over 130 countries have adopted a VAT to tax general consumption.

Standard VAT rates

There is a range of standard VAT rates applying in OECD countries as shown in Chart 8.6. The rates vary from 25 per cent in Denmark, Hungary, Norway and Sweden, to 5 per cent in Japan. For members of the European Union, a minimum standard rate of 15 per cent is prescribed.

In Canada, the standard federal GST rate is 7 per cent. Three of the Canadian provinces — Newfoundland, Nova Scotia and New Brunswick — have fully integrated their sales taxes with the federal GST at an overall rate of 15 per cent.

The VAT base

Although VATs, in principle, have a broad tax base, not all consumption is taxed in practice. Goods and services are excluded from the base by having a zero VAT rate applied or by being input taxed[2] (exempt). The tax base is also reduced in some countries with the implementation of reduced rates for specific goods and services. These approaches allow a variety of policy objectives to be met.

Of the twenty-nine OECD countries which levy a VAT, twenty-seven apply reduced rates and/or zero rates to certain goods and services (Table 8.1).

---

1 VAT is not paid on the sale of the good or service, but the supplier of the good or service is entitled to a refund of the VAT paid on their inputs. In effect, this means that the net VAT paid on the good or service is zero. In Australia, this is referred to as a GST-free supply.

2 VAT is not paid on the sale of the good or service and the supplier is not entitled to a refund of the VAT paid on their inputs. The input taxed approach can be used where it is technically difficult to impose GST on the sale of a particular good or service, but it is not appropriate to allow the sale to be VAT-free. Input taxation provides reduced taxation of supplies to final consumers as the supplier's value add is not subject to tax. For business to business supplies, it imposes a higher effective tax rate because business purchasers cannot offset the VAT paid on the supplier's inputs from their VAT liability.

Seven countries also apply different rates within specific regions (usually overseas municipalities).

Australia does not have any reduced rates but does apply a rate of zero on the sale of particular goods and services.

Table 8.1: Structure of VAT rates for OECD countries, 2005

	Domestic zero rate[(a)]	Reduced rate
Australia	Yes	-
Austria	No	10 and 12
Belgium	Yes	6 and 12
Canada	Yes	-
Czech Republic	No	5
Denmark	Yes	-
Finland	Yes	8 and 17
France	No	2 and 5.5
Germany	No	7
Greece	No	4 and 8
Hungary	No	5 and 15
Iceland	Yes	14
Ireland	Yes	4.8 and 13.5
Italy	Yes	4 and 10
Japan	No	-
Korea	Yes	-
Luxembourg	No	3, 6 and 12
Mexico	Yes	-
Netherlands	No	6
New Zealand	Yes	-
Norway	Yes	7 and 11
Poland	Yes	7
Portugal	No	5 and 12
Slovak Republic	No	-
Spain	No	4 and 7
Sweden	Yes	6 and 12
Switzerland	Yes	2.4 and 3.6
Turkey	No	1 and 8
United Kingdom	Yes	5

(a) Domestic zero rate means tax is applied at a rate of zero to certain domestic sales. It does not include zero rated exports.
Source: OECD Tax Database.

Table 8.2 provides a summary of certain goods and services that are GST-free in Australia and indicates the number of other OECD countries that also exclude these items from their VAT base or tax them at reduced rates.

Table 8.2: Summary of certain goods and services with reduced rates, as at January 2003

	VAT-free (zero-rated)		Lower rate
	Australia	Number of other OECD countries	Number of other OECD countries
Certain food	Yes	4	17
Water supplies	Yes	2	10
Medicine	Yes	6	12
Books/Newspapers	No	6	17
Periodicals	No	3	6
Religious services	Yes	-	-
Education	Yes	-	1
Child care	Yes	-	-
Children's clothing	No	2	2
New housing (residential)	No	1	2

Source: OECD *Consumption Tax Trends*, 2004.

Thirteen OECD countries do not apply a zero rate to any domestic goods or services. Of the OECD-10 (excluding the United States), only Japan, the Netherlands and Spain do not apply a zero rate. Appendix table 8.1.1 shows the zero-rated goods and services in all OECD countries as at January 2003.

Australia is one of only five countries (the others being Canada, Mexico, Ireland, and the United Kingdom) that apply a zero rate to certain food items. Most European countries apply reduced rates to various food items or exempt (input tax) them.

The United Kingdom is the only country to apply a zero VAT rate to new housing. In Australia, GST is not imposed on the sale of existing residential housing by private individuals, but is imposed on the construction and sale of new homes, and on additions and improvements.

The OECD *Consumption Tax Trends* publication (2004 edition) lists common VAT exemptions (that is, input taxed goods and services) across OECD countries as the following: postal services; transport of sick/injured persons; hospital and medical care; human blood, tissues and organs; dental care; charitable work; education; non-commercial activities of non-profit making organisations; sporting services; cultural services (except radio and television broadcasting); insurance and reinsurance; letting of immovable property; financial services; betting, lotteries and gambling; supply of land and buildings; and certain fund-raising events.

Appendix table 8.1.2 shows departures from these 'standard exemptions' for all OECD countries as at January 2003. The majority of countries exempt some goods and services not included on the list of 'standard exemptions'. Similarly, the majority of countries apply VAT to one or more of the goods and services on the list.

Reductions in the VAT base also take the form of registration and collection thresholds. Registration and collections thresholds relieve businesses (based on their size) from the requirement to register for VAT and/or the requirement to collect and charge VAT on supplies of goods and services made. This effectively makes supplies of goods and services by non-registered businesses input taxed.

The implementation of thresholds varies across OECD countries, as shown in Table 8.3. Australia's general registration threshold of A$50,000 is around the mid-range threshold level. Nine countries, however, do not have a general exemption threshold.

Table 8.3: Annual turnover concessions for VAT registration and collection for OECD countries, 2005

	National currency	Registration thresholds(a): General threshold		Reduced threshold for suppliers of services only		Special threshold for non-profit and charitable sector		Collection threshold (if different from registration threshold(b))		Registration allowed prior to exceeding threshold(c)	Minimum registration period(d)
		Nat curr	A$	Nat curr	A$	Nat curr	A$	Nat curr	A$		
Australia	AUD	50,000	50,000			100,000	100,000			Yes	1 year
Austria	EUR	22,000	33,484							Yes	5 years
Belgium	EUR	none						5,580(e)	8,762	No	none
Canada	CAD	30,000	32,234			50,000	89,263			Yes	1 year
Czech Republic	CZK	1,000,000	95,432							Yes	1 year
Denmark	DKK	50,000	8,164							Yes	none
Finland	EUR	8,500	12,631							Yes	none
France	EUR	76,300	117,941	27,000	41,735					Yes	2 years
Germany	EUR	17,500	26,006							Yes	5 years
Greece	EUR	9,000	17,458	4,000	7,759					Yes	5 years
Hungary	HUF	2,000,000	21,550							Yes	2 years
Iceland	ISK	220,000	3,317							Yes	2 years
Ireland	EUR	51,000	69,250	25,500	34,625					Yes	none
Italy	EUR	none								No	none
Japan	JPY	10,000,000	106,900							Yes	2 years
Korea	KRW	none								No	none
Luxembourg	EUR	10,000	14,018							Yes	5 years
Mexico	MXN	none								No	none
Netherlands	EUR	none						1,883(f)	2,869	No	none
New Zealand	NZD	40,000	36,884							Yes	none
Norway	NOK	50,000	7,019			140,000	1,913,017			No	2 years
Poland	EUR	43,800	32,826							Yes	3 years
Portugal	EUR	none						9,975	20,838	No	5 years
Slovak Republic	SKK	1,500,000	119,589							Yes	1 year
Spain	EUR	none								No	none
Sweden	SEK	none								No	none
Switzerland	CHF	75,000	58,422			150,000	369,380			Yes	none
Turkey	TRL	none								No	none
United Kingdom	GBP	58,000	129,774							Yes	none

Source: OECD Tax Database.

(a) Registration thresholds identified in this chart are general concessions that relieve suppliers from the requirement to register for VAT until such time as they exceed the threshold. Except where specifically identified, these thresholds also relieve suppliers from the requirement to charge and collect VAT/GST on supplies made within a particular jurisdiction. Relief from registration and collection may be available to specific industries or types of traders (for example non resident suppliers) under more detailed rules, or a specific industry or type of trader may be subject to more stringent registration and collection requirements.
(b) A collection threshold may apply where a jurisdiction does not have a registration threshold. In these jurisdictions, all suppliers are required to register for VAT/GST, but will not be required to charge and collect VAT/GST until they exceed the collection threshold.
(c) 'Yes' means a supplier is allowed to voluntarily register and collect VAT/GST where their total annual turnover is less than the registration threshold.
(d) Minimum registration periods apply to general concessions. Specific industries, types of traders, or vendors that voluntarily register may be subject to different requirements.
(e) A supplier is allowed to voluntarily collect VAT/GST where their total annual turnover is less than the collection threshold.
(f) This is a net threshold equal to VAT on total annual turnover minus input tax.

8.3.2 Sales taxes

Like VATs, sales taxes are taxes levied on the general consumption of goods and services. They differ from VATs as they are only levied at one stage of the production/distribution process, whether it is at the manufacturing or production stage, or the wholesale or retail stage.

In the United States, almost all states and municipalities impose retail sales taxes on goods and services. Taxing the supply of goods and services from retailers to final consumers is designed to minimise the cascading of tax through the production and distribution processes. A single stage retail sales tax can have very similar economic effects to a VAT as they both create price increases for final retail products and the incidence of both taxes would generally be expected to fall on consumers. A key difference with a retail sales tax is that some components of this tax are more likely to fall on exports and a single stage tax may be easier to avoid.

The retail sales tax rates range from around 3 per cent to 7 per cent across the US states. In addition, municipalities apply their own sales tax rates in conjunction with the state rate. As at July 2004[3], the maximum combined state and local rates varied between 4 per cent in Hawaii (state rate only of 4 per cent) and 11.5 per cent in Arkansas (state rate of 6 per cent and maximum local rate of 5.5 per cent). The average maximum combined state and local rate was 7.4 per cent.

Sales taxes are levied by six Canadian provinces — British Columbia, Manitoba, Ontario, Prince Edward Island, Quebec and Saskatchewan. The rates range from 7 per cent in British Columbia and Saskatchewan to 10 per cent on Prince Edward Island, and the average rate across these provinces is approximately 7.8 per cent. In general, the sales tax systems in Canada differ from a VAT-system as businesses pay sales taxes on their inputs and are unable to offset the tax paid on these inputs against their sales tax liabilities.

The province of Quebec has harmonised its provincial sales tax with the federal GST and has a VAT-style system. However it is not fully integrated with the federal GST system, unlike the provinces of Newfoundland, Nova Scotia and New Brunswick.

8.4 TAXES ON SPECIFIC GOODS AND SERVICES

8.4.1 Excise duty

Excise duties are levied on the consumption of specific goods and were the main form of taxation on consumption before the introduction of general consumption taxes such as sales taxes and value added taxes (VATs).

Excise duties are levied on a limited range of goods and are usually assessed with respect to the weight, volume, strength or quantity of the product. They are also sometimes combined with ad valorem taxes — taxes calculated on the basis of the value of the product. Alcoholic

3 State and local sales tax rates — 1 July 2004. <http://www.taxadmin.org/fta/rate/sl_sales.html>.

beverages, fuels and tobacco products are the three main product groups that are still subject to excise duty in nearly all OECD countries.

In general, excise duty must be paid before excisable goods can be entered into the market for consumption. Also, excise duties are normally part of the VAT tax base. That is, excise duty is first levied on the product and then the excise duty inclusive price is subject to VAT.

Excise duties are levied on products for a variety of reasons but are primarily used to raise revenue. The price effects of the imposition of excise duty can also influence consumer behaviour. For example, excise duty increases prices and broadly reduces the levels of tobacco and alcohol consumption, which is consistent with health policy.

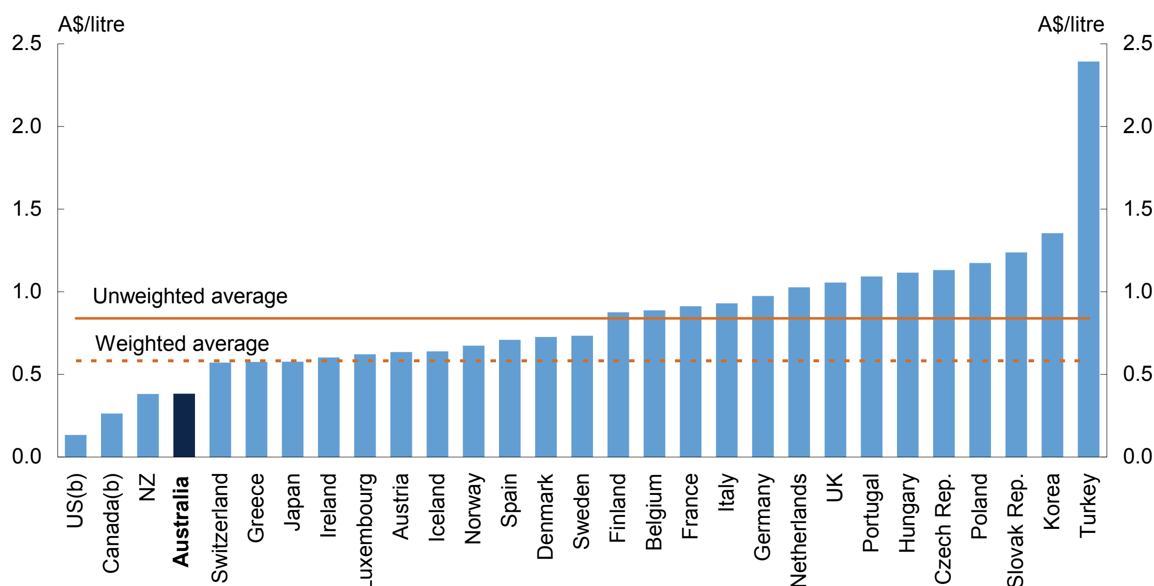
Rates and the implementation of excise duties vary greatly across OECD countries, even though they all generally have the characteristics and objectives outlined above.

Taxation of fuel

The rate of excise duty on unleaded petrol in Australia is A$0.38143 per litre (that is, 38.1 cents a litre). It has been at this level since the indexation of petrol rates to the consumer price index (CPI) ceased in March 2001. Chart 8.7 shows the nominal tax rates on unleaded petrol in OECD countries as at 1 January 2005. Where countries levy more than one specific tax on unleaded petrol, the total combined rate is shown.

As Chart 8.7 indicates, Australia's rate of 38.1 cents a litre is the fourth lowest specific tax rate on unleaded petrol of the OECD-30 countries shown and is less than half the unweighted average rate of A$0.839 per litre and below the weighted average rate of A$0.584 per litre.

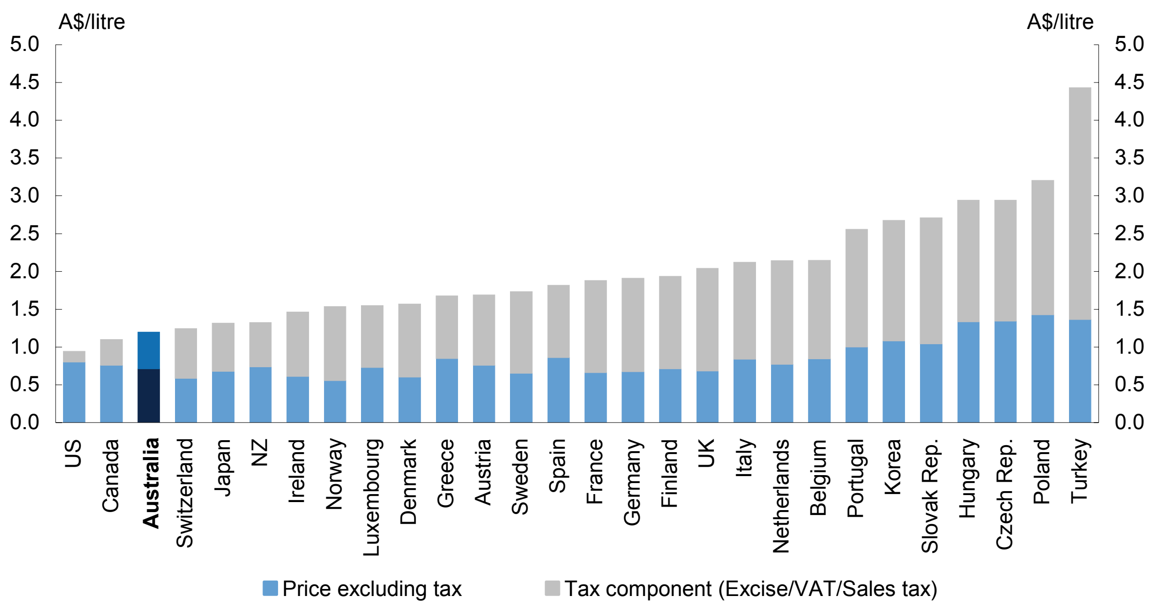
Chart 8.7: Unleaded petrol excise duty rates[(a)]
OECD-30, as at 1 January 2005



(a) Rates have been converted to Australian dollars using OECD Purchasing Power Parities. Mexico levies excise duty on unleaded petrol at an ad valorem rate. Hence, the rate per litre varies according to international petrol prices and is not included in the comparison.
(b) In Canada and the United States, both the federal governments and the state/provincial governments levy taxes on unleaded petrol. An average rate has been calculated for the States and Provinces by the OECD/European Environment Agency, and the combined rates are shown.
Source: Australian Treasury estimates based on OECD and European Environment Agency data.

Chart 8.8 combines the impact of specific taxes with the impact of general consumption taxes (VAT/GST/sales taxes covered earlier in this chapter) on unleaded petrol prices. Under this combined measure, which illustrates the total tax impost on consumers, the average (unweighted) level of tax included in petrol prices for the OECD countries shown was A$1.148 per litre in the last quarter of 2005. In comparison, the level of tax included in unleaded petrol prices in Australia for this quarter was less than half this amount at A$0.490 per litre — the third lowest of both the OECD-10 countries and the OECD-30 countries for which comparable data are available.

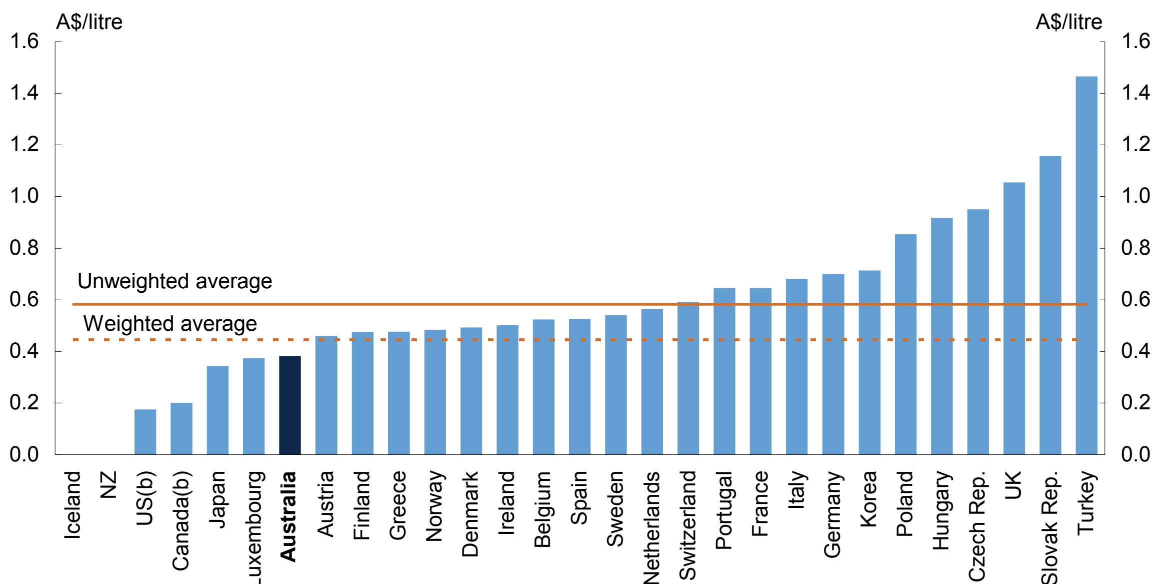
Chart 8.8: Unleaded petrol prices[(a)]
OECD-30, Fourth quarter 2005



(a) Converted to Australian dollars using OECD Purchasing Power Parities. Data is for the fourth quarter of 2005 or the latest available. Data for Iceland and Mexico was not available.
Source: Australian Treasury estimates based on International Energy Agency data.

The following section considers the impact of fuel excises on diesel fuel. Chart 8.9 shows the specific tax rates on diesel in the OECD-30 (except Mexico) as at 1 January 2005. Australia's rate of diesel excise duty of A$0.38143 per litre is below the OECD-30 average of A$0.582 per litre, and is the fifth lowest of the OECD-10 and the seventh lowest of the OECD-30 countries for which comparable data are available.

Chart 8.9: Diesel excise duty rates[(a)]
OECD-30, as at 1 January 2005

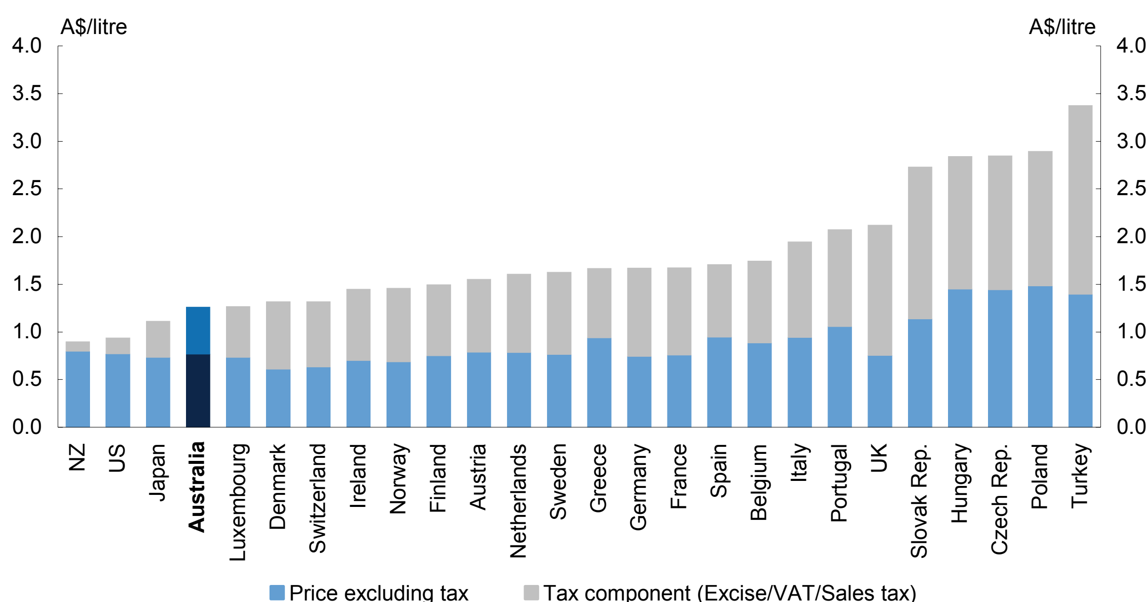


(a) Converted to Australian dollars using OECD Purchasing Power Parities. Mexico levies excise duty on diesel at an ad valorem rate. Hence, the rate per litre varies according to international diesel prices and is not included in the comparison.
(b) In Canada and the United States, both the federal governments and the state/provincial governments levy taxes on diesel. An average rate has been calculated for the states and provinces by the OECD/European Environment Agency, and the combined rates are shown.
Source: Australian Treasury estimates based on OECD and European Environment Agency data.

Iceland and New Zealand do not levy specific taxes on diesel. However, both of these countries apply charges on the use of diesel vehicles. In New Zealand, users of untaxed fuels are required to purchase Road User Charge certificates, usually based on the distance travelled (except in certain off-road situations). Vehicles are charged on the basis of their loaded weight, for example, as at June 2005, a 2-tonne distance licence costs NZ$31.41 per 1,000 km.

For the last quarter of 2005, the average level of tax (both GST and excise duty) included in the price of diesel (used for non-commercial purposes) in Australia was A$0.496 per litre (Chart 8.10). This was the fourth lowest average level of tax for both the OECD-10 and all of the OECD-30 countries for which comparable data are available. It was below the average of A$0.891 per litre. New Zealand is one of the countries that had a lower average level of tax, but this does not take into account its taxes on the use of diesel vehicles.

Chart 8.10: Diesel (non-commercial purposes) prices[(a)]
OECD-30, Fourth quarter 2005



(a) Converted to Australian dollars using OECD Purchasing Power Parities. Data is for the fourth quarter of 2005 or the latest available. Data not available for Canada, Iceland, Korea and Mexico.
Source: Australian Treasury estimates based on International Energy Agency data.

In Australia, there is a federal government grant scheme that provides excise duty relief for diesel fuel used in certain eligible off-road activities, and for diesel fuel and prescribed alternative fuels used in eligible on-road transport. Eligibility for grants under this scheme is generally restricted to businesses.

Some Australian States and Territories also administer fuel subsidy schemes. These subsidies are generally paid directly to the fuel retailer with the expectation that it will be passed on to consumers through reduced prices.

Similarly, many countries provide exemption or refunds of the fuel taxes they impose for certain eligible users and/or activities. These are not generally as comprehensive as in Australia, often being largely restricted to agriculture. The United Kingdom also provides an excise duty rebate for diesel use other than in internal combustion engines.

Taxation of alcoholic beverages

Excise duties are generally applied to alcoholic beverages in two main ways: in relation to the alcoholic content of the product; on the basis of the value of the product; or sometimes both.

In Australia, the rates of excise duty for alcohol (other than wine) are adjusted every August and February in line with half yearly CPI movements. Rates on beer, wine and spirits are indexed yearly in New Zealand and rates for excise duties are usually increased in the annual Budget in the United Kingdom. On the other hand, rates of excise duty seem to increase rarely in the United States (federal excise duties), Canada and Japan.

Generally, beer, wine and spirits are considered as separate products under the broad category of alcoholic beverages. Appendix tables 8.2.1, 8.3.1 and 8.4.1 show the excise duties on beer, wine and spirits for the OECD-10.

These tables demonstrate the differing and complex calculation of excise duties on alcoholic beverages within these countries. It is difficult to draw an overall conclusion about the relative ranking of Australia's excise duties applied to alcoholic beverages.

Taxation of cigarettes

Appendix table 8.5.1 shows the rates of excise duty for cigarettes in the OECD-10. Half of the countries shown use a combination of a specific rate per stick and a rate on the basis of the value of the cigarette. In Australia, there is only a specific rate of excise per stick for cigarettes with less than eight grams of tobacco and, for cigarettes with eight grams or more of tobacco, a per kilogram excise on the tobacco.

Like rates of excise duty on alcoholic beverages (other than wine), rates on cigarettes are adjusted every August and February in line with half yearly CPI movements in Australia.

It is difficult to draw an overall conclusion about the relative ranking of Australia's excise duties applied to cigarettes because of the differing calculation of excise duties on cigarettes between countries.

Box 8.1: Gambling taxes

Gambling taxes are classified under the broad category of taxes on goods and services. Gambling taxes include taxes levied on gambling and betting stakes, and taxes on lottery tickets, electronic gaming machines, casinos, horse racing and football pools. These taxes are typically levied on either the value of investments (bets placed) or on the gross profit of the gambling operator (player loss).

Identifying revenues from these types of taxes in Revenue Statistics is problematic. While some countries attribute revenues to specific gambling taxes, some do not and it is not possible to verify if all gambling taxes levied by a country are separately reported. As a result of these data classification issues, comparisons of revenue from gambling taxes to GDP are not included in the report.

8.4.2 Customs duties

In Australia, customs duty is imposed either as a percentage of the value of the imported good or on a volumetric basis (where duty is applied per unit of quantity) for excise equivalent products (that is, goods which would attract excise if domestically produced).

Table 8.4 shows the rates of duty applying in Australia to passenger motor vehicles, textiles, clothing and footwear; and the general tariff rate applying to other dutiable goods.

Table 8.4: Tariff rates in Australia

	Applying before 1 January 2005 per cent	Applying from 1 January 2005 per cent	Applying from 11 May 2005 per cent
General tariff	5.0	5.0	5.0
Passenger motor vehicles	15.0	10.0	10.0
Textiles, clothing and footwear			
Clothing and finished textiles	25.0	17.5	17.5
Cotton sheeting, fabric, carpet and footwear	15.0	10.0	10.0
Sleeping bags, table linen and footwear parts	10.0	7.5	7.5
Tariff concession order			
Consumer goods	0.0	0.0	0.0
Other (business inputs)	3.0	3.0	0.0

Source: Pocket Brief to the Australian Tax System, Australian Treasury.

As discussed in Chapter 3, there are classification issues with customs duty revenue data. For the European Union countries, customs duty is treated as a supranational tax and is often excluded from the national tax burden. Where the customs impact is merely replicating a domestic excise duty, the OECD standard is to classify the customs duty revenue as excise duty. On the other hand, Australia is one country identified which does not transform its data in that way.

Box 8.2: Insurance taxes

Specific taxes on contracts of insurance fall under the broad category of taxes on goods and services. Most of the OECD-10 countries levy specific insurance taxes. Typically, these taxes are calculated as fixed percentage on the amount of premiums an insurer receives. Rates generally vary depending on the type of insurance risk covered by the contract.

Below are some examples of insurance tax rates for the OECD-10 countries. As comparable information on these taxes is not readily available for all OECD-10 countries, this is not a comprehensive list of insurance taxes and rates levied in these countries.

Table 8.5: Examples of insurance taxes in the OECD-10

	Insurance taxes levied	Example of insurance taxes
Australia	Yes	In Australia, the tax rates for premiums on general insurance range from 7.5 per cent (Queensland) to 11 per cent (South Australia).
Canada	Yes	In British Columbia, the tax rate for premiums on property and automobile insurance is 4.4 per cent.
Ireland	Yes	In Ireland, the tax rate on each insurer's 'assessable amount' of premium income for non-life insurance is 2 per cent.
Japan	-	-
Netherlands	Yes	In the Netherlands, the tax rate for premiums on insurance subject to the basic regime is 7 per cent.
New Zealand	-	-
Spain	Yes	In Spain, the tax rate for premiums on insurance subject to the basic regime is 6 per cent.
Switzerland	Yes	In Switzerland, the tax rate for premiums on insurance subject to the basic regime is 5 per cent.
United Kingdom	Yes	In the United Kingdom, the tax rate for premiums on insurance subject to the basic regime is 5 per cent.
United States	Yes	In California, the tax rate applied to insurers' 'gross premiums' is 2.35 per cent. ('Gross premiums' do not include premiums received for reinsurance and for ocean marine insurance.)

Source: Various, see Chapter 1 (1.4.1).

Of the OECD-10 countries, Australia, Japan and New Zealand apply VAT to certain insurance contracts. In Australia, GST applies to general insurance (not private health insurance or life insurance) and the 'decreasing adjustment method' ensures that only the insurer's margin is taxed, not the entire premium. The remaining OECD-10 countries that levy a VAT input tax (exempt) insurance. For countries that input tax insurance, it is difficult to determine the amount of embedded tax that is included in the price of insurance premiums.

The interactions between VAT, sales taxes and insurance taxes across the OECD-10 countries have not been fully explored here. As a result, an attempt to calculate the total tax burden on insurance premiums has not been undertaken.

Box 8.3: Environment taxes

The OECD defines environmentally related taxes as any compulsory, unrequited payment made to general government levied on tax bases deemed to be of particular environmental relevance.[4]

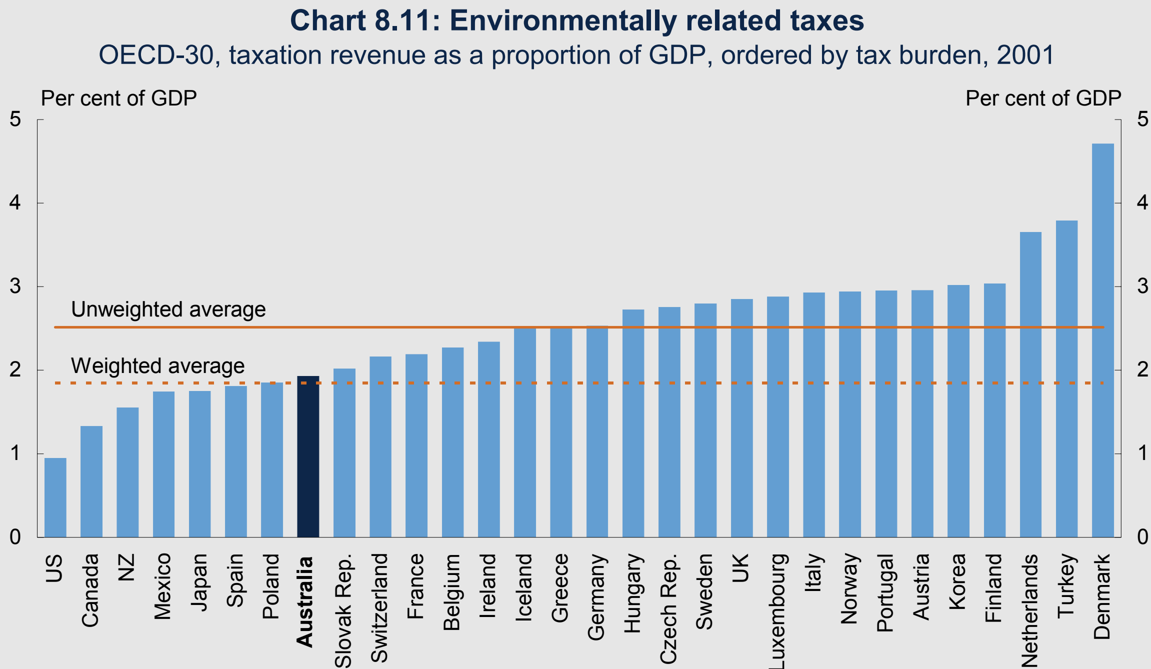
Tax bases included in this definition are energy products, motor vehicles and transport, waste management, ozone depleting substances, as well as bases such as emissions to air and water, and certain non-point sources of water pollution.

This definition includes taxes that were not necessarily introduced with an environmental purpose.

Chart 8.11 shows total revenues from 'environmentally related taxes' for OECD countries in 2001.

Chart 8.11: Environmentally related taxes

OECD-30, taxation revenue as a proportion of GDP, ordered by tax burden, 2001



Source: OECD Environmental Data, 2004.

In all OECD countries, the vast majority of the 'environmentally related taxes' are raised on energy products (mainly excises on motor fuels) and motor vehicle/transport tax bases.

While these bases do have high environmental relevance, it is not clear as to whether taxes on these products are influencing or are used to influence environmental outcomes. In Australia, revenue raising is the key objective of excise duty on fuels.

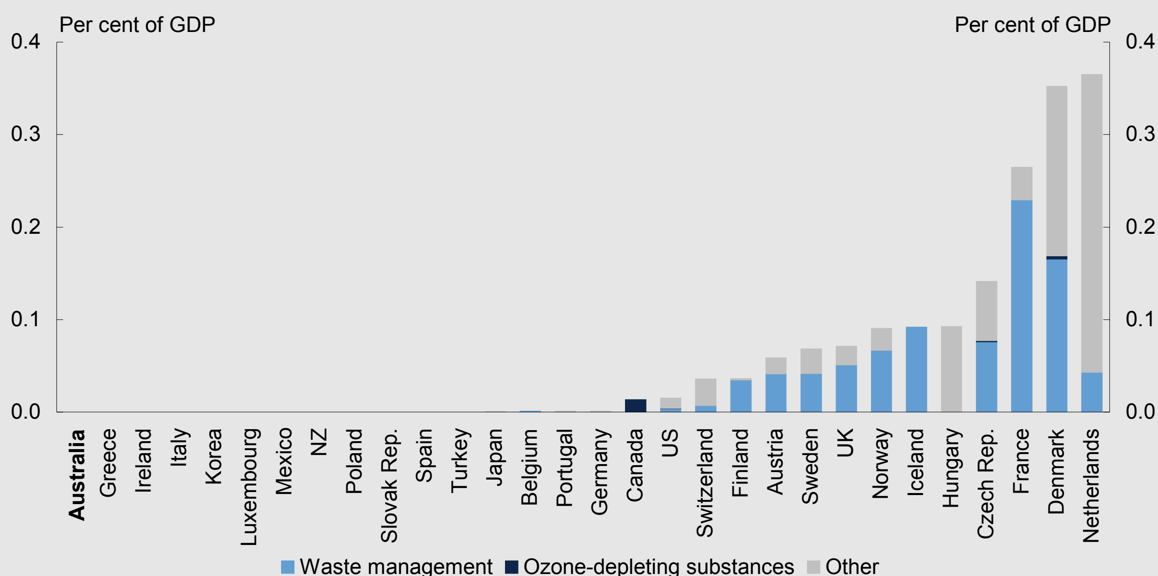
4 OECD Environmental Data 2004.

Box 8.3: Environment taxes (continued)

Taxes on the remaining bases, which could be argued to have a more direct influence on environmental issues/problems, are a small proportion of the 'environmentally related taxes' in all countries. Based on 2001 data, for both the OECD-30 and the OECD-10, about half of countries do impose specific environmental taxes and half do not, as indicated in Chart 8.12. It is known that many countries have introduced 'environmentally related taxes' since then.

Chart 8.12: Specific environmentally related taxes

OECD-30, taxation revenue as proportion of GDP, ordered by tax burden, 2001



Source: OECD Environmental Data, 2004.

From 1 January 2001, an excise duty of A$0.05449 per litre has been levied on lubricants, oils and greases in Australia. While not formally hypothecated, the revenue raised from the excise duty (around A$20 million per annum) offsets payments made to promote oil recycling under the Product Stewardship (Oil) scheme.

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APPENDIX 8.1: VALUE ADDED TAXES

Appendix table 8.1.1: Zero and reduced rates as at 1 January 2003 — OECD-30

Country	Zero rate (GST-free)[a]	Lower rate
Australia	Specific basic food and beverages, health, child care, religious services, supplies of going concerns, water, sewerage and drainage, certain supplies of transport and related matters, precious metals, international mail, grants of freehold and similar interests by governments, farm land, cars for use by people with disabilities, exports and consumption outside Australia, supplies through inwards duty-free shops, education, non-commercial activities of charitable institutions and raffles and bingos conducted by charitable institutions.	—
Austria	—	Agriculture, books, food, forestry, hospitals, newspapers, art, culture, letting transport, supply of wine by farmers (12 per cent).
Belgium	Cars for the handicapped, newspapers and certain weeklies.	Agriculture, food, water distribution, pharmaceuticals, books, works of art, collectors' items and antiques delivered by their authors/creators or their heirs, or imported, funeral services, devices for the handicapped, passenger transport, shows, hotels and camping sites, renovation of dwellings over five years old, private homes and establishments for the handicapped, subsidised institutional housing, coal and coke, some labour intensive services (small repair services).
Canada	Medicine, basic groceries, exports, certain financial services (usually to non-residents), certain agriculture and fishing products, medical devices, international travel and transport services, international organisations and officials, precious metals, (sales of 25 cents or less made through mechanical coin-operated devices).	—
Czech Republic[b]	—	Food, agricultural products, heating, personal transport, medicine, art, cultural service, laundry, books, newspapers, handicap equipment, most services.
Denmark	Newspapers	—
Finland	Subscribed newspapers and periodicals, printing services for certain membership publications, certain vessels.	Food, non-alcoholic drinks, animal feed, medicine, books, passenger transport, accommodation, TV licence, admission to cultural, entertainment and sporting events and cinema performances. Use of sports facilities. Works of art supplied by their creators or imported.
France	—	Medicine, handicap equipment, books, hotels, entertainment, Author's rights, museums, transport, accommodation, agriculture. Books, catering, newspapers, water, work on dwellings over two years old.
Germany	—	Food, books, newspapers, plants, flowers, devices for the handicapped, certain cultural events, museums, zoos, circuses. Charitable work if not exempt, author's rights, transport (only applies to passenger transport by ship and to local public transport).

Appendix table 8.1.1: Zero and reduced rates as at 1 January 2003 — OECD-30 (continued)

Country	Zero rate (GST-free)[a]	Lower rate
Greece	—	Electric energy, transport of passengers, food, water supply, medicine, handicap equipment, admission to shows, agricultural services, hotels, restaurants, sporting facilities, funeral services, authors and artists (if not exempt), books, press.
Hungary	Medicine for human consumption, books for public education, equipment for the blind and disabled (to be abolished on 1 January 2004).	Food, electric energy, books, equipment for the disabled, live animals, water, pharmaceutical products, mineral fuel for heating, newspapers, repairs of medical appliances, broadcasting, agricultural and fishery services, accommodation, transport, veterinary services, film services, art services, library services, bath services, funerals.
Iceland	International transport provisions, fuel and equipment delivered for use in ships and aircraft engaged in international traffic, ship-building.	Food, newspapers, books, hotels, warm water, electricity and fuel oil used for the heating of houses and swimming pools.
Ireland	Books, children's clothing and footwear, oral medicine, certain medical equipment, food products, seeds, fertiliser.	Newspapers and certain periodicals, fuel for certain purposes, electricity, works of art, veterinary services, agricultural services, car and boat hire, driving instruction, photographs, concrete, holiday accommodation, restaurant/hotel meals, building services, immovable goods, repair services, waste disposal, certain foods, tour guide services, admission to cinemas/certain musical performances and sporting facilities.
Italy	Scrap iron	Food, medicine and health products/services for the handicapped, telecommunications, housing, books, newspapers, weekly publications, combustible gas for home heating, urban waste, purification stations, renewable-source energy, works of art, shows and transport. Accommodation let by building enterprises (10 per cent).
Japan	—	—
Korea	Certain machinery and materials for agriculture, fishery, livestock and forestry, certain equipment for the handicapped.	—
Luxembourg	—	Accommodation, admission to cultural and sporting events, agriculture, author's rights, books, certain medical equipment, aids and other appliances normally intended to alleviate or treat disability, certain labour intensive services, children's clothing, construction of dwellings, electricity, foodstuffs for human and animal consumption, funeral services, gas, newspapers, passenger transport, periodicals, pharmaceutical products, renovation of dwellings over 20 years old, restaurant services, services, supplied in connection with refuse collection and waste treatment, use of sporting facilities, water, works of art delivered by their authors/creators or their heirs, or imported.
Mexico	Sale of non-processed animals and vegetables (including wood in pieces) except rubber, patent medicines, milk, water, ice, food except processed food, smoked salmon and caviar, agricultural equipment, machinery and fishing boats, the wholesale of gold, gold bullion and jewellery, some agricultural and fishing services, the letting of some agricultural machinery and equipment, the export of goods and services, the sale of books and newspapers edited by the taxpayer himself, the provision of the water supply service for domestic purposes.	Sale of goods and services in the border regions.

Appendix table 8.1.1: Zero and reduced rates as at 1 January 2003 — OECD-30 (continued)

Country	Zero rate (GST-free)[a]	Lower rate
Netherlands	—	Accommodation, agriculture, books, catering, food, goods and services for the handicapped, medicine, newspapers, magazines, passenger transport, water, entrance fess for sport events/amusement parks/museums/cinemas/zoos/circuses, restaurant/hotel meals, aids for the visually handicapped, use of sports accommodation, art and antiques, certain labour intensive services.
New Zealand	The supply of a taxable activity (business) as a going concern, the supply of fine metal (gold, silver or platinum) from a refiner in fine metal to a dealer in fine metal, the supply by a local authority of the local authorities petroleum tax (the distribution of the local authorities petroleum tax between local authorities).	For long-term stay in a commercial dwelling, certain services, if provided as part of the right to occupancy, are subject to tax at the standard rate on 60 per cent of the value of the supply (an effective lower rate on such services of 7.5 per cent).
Norway	Books, newspapers, certain aircraft and ships, transport services for ferrying vehicles, second-hand vehicles, electricity and district heating in the northern part of Norway, electric motor cars.	Food and public broadcasting (12 per cent).
Poland	Basic agricultural means of production, books and specialised magazines, sea rescue services, goods and services supplied on ferries, goods designated for fire protection.	Goods for children, basic building material, some construction services, some goods connected with health protection, musical instruments, catering services, passenger transport, building of bridges, highways, certain hotel and restaurant services.
Portugal	—	Five per cent: Essential foodstuff, water, medicine, devices for the handicapped, medical services (when not exempt), books, newspapers, electricity, passenger transport, admission to cultural and sporting events, natural gas, hotels and similar, social housing, some goods used in agriculture. Twelve per cent: Some other foodstuffs, restaurant services, diesel fuel for agriculture and heating oil, still wine, machinery mainly used in agricultural production, tools, machines and other equipment solely or mainly designed for collecting and using alternative energy sources.
Slovak Republic[c]	—	Live animals, food, non-alcoholic drinks, water, coal, peat and coke, thermal energy, electric energy, gas, heating, wood for fuel, pharmaceutical products, exercise books, books, newspapers, magazines and periodicals, art, equipment for the handicapped, medicine, agriculture, hunting, forestry, fishery services, distribution of water, gas fuels and electricity, repair of shoes, hotel services, transport, services related to broadcasting and the transmission of TV and radio signals, research and development, legal services, architectural and engineering services, laundry services, public administration and defence, education, health and social welfare services, cleaning of waste water and solid waste disposal, recreation, cultural and sports activities, funeral services, some building services and building materials, transfer, transition and letting of immovable property.
Spain	—	Books, social accommodation, catering, certain cultural and entertainment services, food (for human and animal consumption), hotels, restaurants, supplies to the handicapped, medicines and other medical devices (for example, lenses), transport, newspapers, public amenities, burial services, agriculture and forestry products used as food, goods used in agricultural and forestry undertakings, including flowers and plants, hairdressing and complementary services, minor work on private housing, cleaning, waste treatment, cleaning of public sewage, water, private and social housing, the supply of cleaning and maintenance services.
Sweden	Commercial aircraft and ships, aircraft fuel, prescribed medicine, printing of certain membership publications.	Accommodation, food, passenger transport, ski-lifts, newspapers, works of art owned by the originator, import of antiques, collector's items and works of art, culture (theatre, cinema, etcetera), author's rights, books, newspapers, magazines, zoos, commercial sports events, commercial museums.

Appendix table 8.1.1: Zero and reduced rates as at 1 January 2003 OECD-30 (continued)

Country	Zero rate (GST-free)[(a)]	Lower rate
Switzerland	Certain supplies of goods and services to international airlines, supplies of some specific sorts of gold.	Water, food, medicine, books, newspapers, non-commercial television, accommodation, certain supplies in connection with agricultural production.
Turkey	—	Agricultural products, leasing, second-hand cars, newspapers, books, magazines, basic foodstuffs, natural gas, cinema, theatre, opera, ballet and education.
United Kingdom	Certain services and goods supplied to charities, children's clothing, food, passenger transport, books, newspapers, domestic sewage and water, prescribed drugs, medicine, certain aids and services for disabled people, new housing, residential and some charity buildings, alterations to listed buildings.	Fuel and power for domestic and charity use (5 per cent). Certain energy saving materials supplied together with fitting services to recipient of 'Passport Benefits'.

(a) Exports of goods, intangibles and services are generally zero rated in all OECD countries.
(b) In Czech Republic a higher rate applies to cars, TV, washing machines, jewellery, road transport of goods, services of tourist agencies, accommodation, restaurant, repairs.
(c) Slovak Republic no longer apply reduced rates.
Source: OECD *Consumption Tax Trends*, 2004.

Appendix table 8.1.2: VAT exemptions as at 1 January 2003 — OECD-30

Country	Exemptions	Taxation of 'standard exemptions'[(a)]
Australia	Financial services, residential rent and premises, certain supplies of precious metals, school canteens operated by non-profit bodies, fund raising events conducted by charitable institutions.	Domestic postal services, sporting services, cultural services excluding religious services (zero rate), insurance and reinsurance excluding health insurance (zero rate), gambling (including lottery tickets and betting), supplies of land and buildings (except certain supplies of farm land — zero rate), commercial property and new residential property (except certain supplies of commercial property where an enterprise is continuing its operation).
Austria	—	Letting (private housing)
Belgium	Legal services (including public notaries and bailiffs).	—
Canada	Child care legal aid, ferry, road and bridge tolls, standard government services.	Lotteries and gambling, supply and leasing of commercial land and buildings, domestic postal services.
Czech Republic	Public television and radio, supplies of enterprises.	Cultural services
Denmark	Passenger transport, burials, products of artistic work, travel agents.	Theatre and cinema
Finland	Services of performers, copyright to literary and artistic works, certain transactions by blind people, public cemetery services, self-picked natural berries.	Postal services, cultural services, letting of commercial buildings in certain cases (optional).
France	Construction, improvement, repair and maintenance work on monuments, cemeteries and graves commemorating war victims undertaken for public authorities and non-profit bodies, new industrial waste and recyclable material, commodity futures transactions carried out on a regulated market, services rendered by resource consortia to their members composed of natural or legal persons that are VAT exempt or not subject to VAT.	Letting of immovable property, full taxation for letting of developed immovable property and land for professional use, option to tax for letting of undeveloped immovable property for professional use in certain circumstances and letting of land and buildings for agricultural use, transport services for sick/injured persons in vehicles not specially equipped for this purpose and/or carried out by persons who do not have administrative certification.
Germany	—	—
Greece	Legal services, authors' rights, artists' services, public radio and TV, supply of water by public bodies.	Cultural services (under conditions — admission to theatres, cinemas, concerts, etc: lower rate).
Hungary	Public radio and TV broadcasting, mass sports events, services rendered by intermediaries (in case of exempt supply of goods and services), lending of buildings for education, sport and cultural purposes, transfer of creditors and ownership rights, compulsory social security insurance, public administration.	Safe transactions, dental care, transport of sick or injured person when not part of the human medical care, the letting of immovable property which is not for housing purposes is taxed at 25 per cent, supply of buildings and land is taxed if it is not for housing purposes.
Iceland	Sports, passenger transport, authors, composers, burials, travel agents.	—
Ireland	Passenger transport, broadcasting, supply of water by public authorities, admissions to sporting events, child care, funeral undertaking, travel agents/tour operators.	Long-term letting of commercial immovable property, supply of land and buildings.
Italy	Municipal passenger transport, burials.	Supply and letting of commercial land and buildings (standard rate). Residential housing taxed only when let by building enterprises (at lower rate of 10 per cent).
Japan	Social welfare services, sale of certain kinds of equipment for the physically handicapped, public services, securities.	Hospital and medical care, education, insurance and reinsurance, financial services, supply of land.

Appendix table 8.1.2: VAT exemptions as at 1 January 2003 — OECD-30 (continued)

Country	Exemptions	Taxation of 'standard exemptions'[(a)]
Korea	Certain public transport, supply of water and coal, mineral oil used for certain purposes in agriculture and fishery, funeral undertaking, certain personal services similar to labour.	Rental and supply of commercial buildings, commercial cultural services, gambling in licensed clubs.
Luxembourg	—	—
Mexico	Standard exemptions, magazines, gold and silver coins and shares, foreign currency, retailing of gold bullion, authors' rights, public transport of passengers by land, agriculture, forestry and fishing activities.	Postal and insurance services except life and agricultural insurance, letting of commercial buildings and financial services for consumer credits and personal credits.
Netherlands	Standard exemptions, burials, cremations, public broadcasting, sports clubs, the services of composers, writers and journalists.	Cultural services (mostly lower rate), letting of immovable property other than houses (only at combined request by letter and hirer), supply of immovable property (only at the combined request of supplier and purchaser), the use of sports accommodation.
New Zealand	—	Postal services, human blood, tissues and organs, hospital and medical care, transport of sick/injured persons, dental care, charitable work, certain fund raising events, education, non-commercial activities of non-profit making organisations (other than unconditional gifts), cultural services, sporting services, insurance and reinsurance (other than life insurance and reinsurance), letting of immovable property (other than residential accommodation), betting, lotteries and gambling, supply of land and buildings (other than land and buildings which have been used for the provision of residential accommodation for five years or more).
Norway	Passenger transport, burials, accommodation in hotels.	Postal services
Poland	Agricultural services, taxi services, research and development services, funeral, cremation and cemetery services, public broadcasting, public television and radio, certain veterinary services.	Pawn activity except for service provided by banks, rental or tenancy of the dwelling immovable property used for commercial purposes.
Portugal	Agriculture	—
Slovak Republic	Public television and radio.	—
Spain	Copyright to literature and works of art.	Some cultural services provided consumers pay for them.
Sweden	Public television and radio, authors' rights, public cemetery services, social services.	Postal services, most cultural services, letting of commercial buildings in certain cases (optional).
Switzerland	Taking care of children and young people under certain conditions, social services, social security services, provision of agency workers under certain conditions, certain second-hand goods.	Parking for cars unless additional to renting out of real estate, renting out of areas and individual rooms at fairs, certain bank services, provision of prosthesis and orthopaedic equipment.
Turkey	Deliveries and repairs of maritime, aircraft or railway transport vehicles used for business activities, social services, water used in agriculture.	Educational and cultural services, newspapers, books, magazines (lower rate), postal services, sale of commercial buildings, letting, radio and television broadcasting, hospitals, lotteries and gambling.
United Kingdom	Burials and cremations, sports competitions, certain luxury hospital care.	The freehold sales of new commercial buildings (standard rated for three years from completion date) and 'option to tax' for other ordinarily exempted supplies of commercial buildings, gaming machines and certain gambling in licensed clubs.

(a) 'Standard exemptions' are the following: postal services, transport of sick/injured persons, hospital and medical care, human blood, tissues and organs, dental care, charitable work, education, non-commercial activities of non-profit making organisations, sporting services, cultural services (except radio and television broadcasting), insurance and reinsurance, letting of immovable property, financial services, betting, lotteries and gambling, supply of land and buildings, certain fund-raising events.

Source: OECD *Consumption Tax Trends*, 2004.

APPENDIX 8.2: TAXATION OF BEER

Appendix table 8.2.1: Taxation of beer — OECD-10

	Specific excise duty per hectolitre per degree Plato		Specific excise duty per hectolitre per degree alcohol		VAT rate	Excise duty on low alcohol (under 2.8 per cent alcohol by volume) beer Excise per hectolitre of product		Other features of the excise duty system on beer	
	National currency	A$	National currency	A$	Per cent	National currency	A$	Excise rates progressive by strength	Low rates for small producers
Australia	See note		See note		10.00			Yes	Yes - see note
Canada			27.99	30.37	7 or 15	See note		Yes	No
Ireland			19.87	26.47	21.00	See note		No	No
Japan			See note		5.00			No	No
Netherlands	2.10	3.08			19.00			Yes	Yes
New Zealand			See note		12.50	See note		No	No
Spain	See note				16.00			No	No
Switzerland	24.75	18.64	See note		7.60	See note		No	No
United Kingdom			11.89	25.99	17.50			No	Yes
United States			21.00	28.37	-			No	Yes

Source: OECD *Consumption Tax Trends*, 2004.

Notes:

Australia

As at 1 January 2003, the excise duty rates for beer in individual containers not exceeding 48 litres are:

(a) A$29.36 per litre of alcohol where volume of alcohol does not exceed 3 per cent; and

(b) A$34.22 where volume of alcohol exceeds 3 per cent but does not exceed 3.5 per cent or exceeds 3.5 per cent.

The rates for beer in individual containers exceeding 48 litres are:

(c) A$5.86 per litre of alcohol where volume of alcohol does not exceed 3 per cent;

(d) A$18.41 where volume of alcohol exceeds 3 per cent but not 3.5 per cent; and

(e) A$24.09 where volume of alcohol exceeds 3.5 per cent.

Each rate is calculated on the amount by which the alcohol content (by volume) exceeds 1.15 per cent. Beer that does not contain more than 1.15 per cent by volume of alcohol is free of excise duty. Though a microbrewery pays excise duty at the required rates, refunds are available to microbreweries meeting certain requirements.

Canada

Excise duty rates are as follows per hectolitre of product:

(a) over 2.5 per cent vol — C$27.985;

(b) over 1.2 per cent vol but not more than 2.5 per cent vol — C$13.99; and

(c) 1.2 per cent vol or less — C$2.591.

Ireland

Excise duty rate nil below 1.5 per cent ABV.

Japan
Excise duty rates are ¥22,200 per hectolitre of product.

Netherlands
For beer that is sold usually, that is, beer of 12 degree Plato is in the range 11-15 degree Plato (€25.11: 12 = €2.10 per degree Plato).
Excise duty rates are as follows per hectolitre of product:
(a) up to 7 degree Plato €5.50;
(b) 7-11 degree Plato €18.84;
(c) 11-15 degree Plato €25.11; and
(d) over 15 degree Plato €31.40.
Rates for small breweries (annual production up to 200 000 hl) are as follows:
(e) up to 7 degree Plato the above mentioned rate;
(f) 7-11 degree Plato €17.43;
(g) 11-15 degree Plato €23.23; and
(h) over 15 degree Plato €29.05.

For beer with an alcohol content of 0.5 per cent, the VAT rate is 6 per cent.

New Zealand
The excise duty rate for beer containing more than 2.5 per cent vol is NZ$21.647 per litre of alcohol in finished product.
The rate for beer containing more than 1.15 per cent vol but not more than 2.5 per cent vol is NZ$32.465 per hl of product. There is no excise duty on beer containing less than 1.15 per cent vol.

Spain
Beer with an alcoholic content not exceeding 1.2 per cent vol is free of excise duty.
The rate for beer between 1.2 per cent and 2.8 per cent is €2.32 per hl; beer with an alcoholic degree > 2.8 per cent and a degree Plato < 11 = €5.34/hl; beer with a degree Plato > 11 and not > 15 = €8.38/hl; beer with a degree Plato > 15 and not > 19 = €11.43/hl; beer with a degree Plato > 19 = €0.77 per hl and per degree Plato. There is no tax on beer in Ceuta and Melilla — Spanish cities situated in the North of Africa.

Switzerland
Uniform rate for all beers from 0.5 to 15.0 degrees alcohol.

United Kingdom
Beer with an alcoholic content not exceeding 1.2 per cent vol is free of excise duty.
Reduced duty rates apply for independent breweries producing no more than 30,000 hectolitres. For breweries producing between 5,000-30,000 hectolitres an arithmetic formula is used to determine the rate.

United States
The weighted average Federal and State excise tax rate is US$21 per hectolitre of product. The Federal tax is US$18 per barrel (31 gallons). (26.42 US gallons = 1 hectolitre.) Small domestic brewers who produce less than 2 million barrels of beer per calendar year pay US$7 per barrel on the first 60,000 barrels. There is no progressive rate structure based on alcohol content and no Federal VAT. However, in the majority of States, sales taxes apply.

APPENDIX 8.3: TAXATION OF WINE

Appendix table 8.3.1: Taxation of wine — OECD-10

	Still wine			Sparkling wine			Low-alcohol (still) wine (< 8.5 per cent alc)		
	Excise per hectolitre of product			Excise per hectolitre of product			Excise per hectolitre of product		
	National currency	A$	VAT per cent	National currency	A$	VAT per cent	National currency	A$	VAT per cent
Australia	See note		10.0	See note		10.0	See note		10.0
Canada	51.22	55.58	7 or 15	51.22	55.58	7 or 15	See note		7 or 15
Ireland	273.00	363.73	21.0	546.01	727.47	21.0	90.98	121.22	21.0
Japan	5,650.00	54.86	5.0	5,650.00	54.86	5.0			
Netherlands	59.02	86.67	19.0	201.24	295.52	19.0	29.51	43.33	19.0
New Zealand	See note		12.5	See note		12.5	See note		12.5
Spain			16.0			16.0			
Switzerland			7.6			7.6			7.6
United Kingdom	154.37	337.47	17.5	220.54	482.12	17.5			
United States	45.00	60.80	-	113.00	152.66	-	See note		-

Source: OECD *Consumption Tax Trends*, 2004.

Notes:

Australia

No distinction is made between still, sparkling or low alcohol wine, all are taxed at 10 per cent by the Goods and Services Tax (GST) and all are liable for the Wine Equalisation Tax (WET). The WET was introduced on 1 July 2000 to replace the difference between the previous 41 per cent wholesale sales tax and the GST of 10 per cent. The WET is levied at 29 per cent of the wholesale value. The WET applies to the following alcoholic products provided they contain more than 1.15 per cent by volume of ethyl alcohol:

(a) grape wine;
(b) grape wine products such as marsala, vermouth, wine cocktails and creams;
(c) fruit wines or vegetable wines; and
(d) cider, perry, mead and sake.

From 1 October, 2004, a rebate of WET applies to the first A$1 million of wholesale sales value of production for each producer. The State Governments will also operate separate rebate/subsidy schemes in limited circumstances for cellar door sales.

Canada

A rate of C$0.5122 per litre applies to wine with an alcohol vol of more than 7 per cent absolute ethyl alcohol by vol. The rate is C$0.2459 per litre on wine of more than 1.2 per cent absolute ethyl alcohol by vol, but not more than 7 per cent; and for all wine with 1.2 per cent vol or less the rate is C$0.0205 per litre.

Ireland

The rate for low alcohol wine applies to wine with an alcoholic content of less than 5.5 per cent vol.

Netherlands
Excise duty rate for low alcohol sparkling wine is €38.16. For low alcohol wine < 5 per cent, the VAT rate is 6 per cent.

New Zealand
The excise duty rate for grape wine is NZ$216.47 per hectolitre of product.

Spain
Intermediate products — products to which distilled alcohol has been added — and with a vol of alcoholic degree between 1.2 per cent vol and less than 22 per cent are taxed according to the following rates:

(a) alcoholic degree > 1.2 per cent and less than 15 per cent = €27.50 per hl; and
(b) others = €45.83 per hl.

United Kingdom
Reduced excise duty rates for lower strength drinks (wine categories) are as follows:

(a) exceeding 1.2 per cent — not exceeding 4 per cent alcohol by vol = £47.58 per hl;
(b) exceeding 4 per cent — not exceeding 5.5 per cent alcohol by vol = £65.42 per hl; and
(c) low strength sparkling wine exceeding 5.5 per cent — less than 8.5 per cent = £166.70 per hl.

There is also a rate of duty in the band exceeding 15 per cent but not exceeding 22 per cent: £208.52 per hl (wine and made wine). The United Kingdom also charges excise duty on cider and perry products.

The following rates per hl applied on 1 January 2003:

(d) exceeding 1.2 per cent but not exceeding 7.5 per cent: £25.61;
(e) exceeding 7.5 per cent but less than 8.5 per cent: £38.43; and
(f) sparkling wine and perry — exceeding 5.5 per cent but less than 8.5 per cent: £166.70.

Any still cider product which has a strength of 8.5 per cent and over is dutied as a made wine.

United States
The weighted average Federal and State excise tax rate is US$45 per hectolitre of product for still wine up to 14 per cent vol, and US$113 for sparkling wine.
The Federal excise tax rates are as follows:

(a) up to 14 per cent vol US$1.07 per gallon;
(b) 14 per cent — 21 per cent vol US$1.57 per gallon;
(c) 21 per cent — 24 per cent vol US$3.15 per gallon;
(d) artificially carbonated wine US$3.30 per gallon; and
(e) sparkling wine US$3.40 per gallon (26.42 US gallons = 1 hectolitre.)

There is no Federal VAT, however, in the majority of States, sales taxes apply.

APPENDIX 8.4: TAXATION OF ALCOHOLIC BEVERAGES

Appendix table 8.4.1: Taxation of alcoholic beverages — OECD-10

	Tax per hectolitre of absolute alcohol			
	Excise duty			
	National currency	A$	VAT (per cent)	Small distillery rate
Australia	See note		10.0	No
Canada	1,106.60	1,200.82	7 or 15	No
Ireland	3,925.00	5,229.46	21.0	No
Japan	See note		5.0	No
Netherlands	1,775.00	2,606.55	19.0	No
New Zealand	2,164.70	1,990.82	12.5	No
Spain	685.15	1,247.49	16.0	Yes
Switzerland	2,900.00	2,183.89	7.6	No
United Kingdom	1,956.00	4,275.98	17.5	No
United States	920.00	1,242.92	-	No

Source: OECD *Consumption Tax Trends*, 2004.
Notes:
Australia
As at 1 January 2003, the excise duty rate of A$57.97 per litre of alcohol is applied to fruit brandy, whisky, rum, liquors and other excisable beverages (but not beer) of alcoholic strength exceeding 10 per cent. Brandy attracted the rate of A$54.13 per litre of alcohol and a lower rate of A$34.22 per litre of alcohol applied to other excisable beverages (but not beer) of alcoholic strength not exceeding 10 per cent.

Canada
Spirits are subject to excise duty at the rate of C$11.066 per litre of absolute ethyl alcohol by volume. Spirits containing not more than 7 per cent absolute ethyl alcohol by volume are subject to excise duty at the rate of C$0.2459 per litre.

Ireland
Reduced rate of excise duty on spirits with an alcoholic content under 5.5 per cent abolished from 5 December 2002.

Japan
Excise duty rates are as follows:
(a) Whisky and brandy (40 per cent vol.) ¥40,900;
(b) Spirits (37 per cent vol.) ¥36,718.8;
(c) Shochu Group A and B (25 per cent vol.) ¥24,810.

Netherlands
For low alcohol spirits with an alcoholic content < 1.2 per cent, the VAT rate is 6 per cent.

New Zealand
For alcoholic beverages with 0-14 per cent alcoholic content, the excise duty rate is NZ$2,164.7 per hectolitre of absolute alcohol. For alcoholic beverages above 14 per cent in alcoholic content, the excise duty rate is NZ$3,942.6 per hectolitre of absolute alcohol (with the exception of unfortified wine and vermouth which has the rate of NZ$216.47 per hectolitre of product).

Spain
The excise duty rate in the Canary Islands is €494.06 per hl of pure alcohol. There is a special regime for small distilleries for which the rate is €599.57 per hl (or €466.82 in the Canary Islands).

Switzerland
Weighted average rate.

United Kingdom
All drinks over 22 per cent are dutied as spirits.

United States
The weighted average Federal and State excise tax rate is US$920 per hectolitre. The Federal excise tax rate is US$13.50 per proof gallon in 2003. A proof gallon is a US gallon (3.785 litres) containing 50 per cent alcohol. There is no Federal VAT, however, in the majority of States, sales taxes apply.

APPENDIX 8.5: TAXATION OF CIGARETTES

Appendix table 8.5.1: Taxation of cigarettes — OECD-10

	Cigarettes			
	Specific excise per 1,000		Excise on value	
	National currency	A$	(per cent of RSP)(a)	VAT (per cent)
Australia	215.24	215.24	0.0	10.0
Canada	79.25	86.00	na	7 or 15
Ireland	124.94	166.46	18.5	21.0
Japan	7,072.00	68.67	0.0	5.0
Netherlands	53.27	78.23	20.5	19.0
New Zealand	263.41	242.25	0.0	12.5
Spain	3.00	5.46	54.0	16.0
Switzerland	72.00	54.22	53.8	7.6
United Kingdom	94.24	206.02	22.0	17.5
United States	See note			

(a) RSP — Retail selling price.
Source: OECD *Consumption Tax Trends*, 2004.
Notes:
Australia
The taxation of cigarettes applies a per stick rate if tobacco content per stick does not exceed 0.8g. Where the tobacco content exceeds 0.8g per stick, the excise duty rate is A$269.05 per kg.

Canada
Provinces add their own taxes on tobacco products. For cigarettes, these range between C$103 and C$210 per thousand. Some provinces also apply an *ad valorem* tax.

Japan
The tax consists of a national element, a prefectural element and a municipal element.

New Zealand
The rate shown for cigarettes is the rate of 1,000 pieces not exceeding 0.8 kg in actual tobacco content. Cigarettes exceeding 0.8 kg in actual tobacco content per 1,000 are taxed as cigars. Excise duty rate for cigars is NZ$329.27 per 1kg of tobacco content of cigars.

United States
State taxes vary widely. The weighted average of Federal and State taxes on a pack of cigarettes was US$0.87 in 2002. Payment under the 1998 Master Settlement Agreement between tobacco companies and the individual States have been estimated to add another US$0.45 per pack. In 2003, Federal specific excise tax rates on tobacco were: US$19.50 per thousand for small cigarettes (no more than 3 pounds per thousand); US$40.95 per thousand for large cigarettes. There is no Federal VAT.

Chapter 9

Property and transaction taxation

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9. PROPERTY AND TRANSACTION TAXATION

SUMMARY

Although Australia has a comparatively high reliance on property and transaction taxes (3.0 per cent of GDP) and is seventh highest of the OECD-30, in terms of the OECD-10, Australia's overall tax burden is much closer to the unweighted average (2.7 per cent).

Most property and transaction taxes in Australia are levied by sub-national governments — the State, Territory and local governments.

Australia's tax burden from taxes on immovable property is below the unweighted average of the OECD-10.

Of the OECD-10, Australia has the highest financial and capital transaction tax burden (includes taxes such as stamp duties on conveyances).

Australia's top rate for stamp duty on conveyances (7 per cent) is the equal second highest of the OECD-10.

Australia is the only OECD-10 country which does not levy either a recurrent wealth tax, or any estate, inheritance or gift taxes.

9.1 INTRODUCTION

Property and transaction taxes cover taxes levied on the use, ownership or transfer of property, including:

- taxes on immovable property, for example, land tax and municipal rates;
- taxes on net wealth;
- taxes on the change of ownership of property through inheritance or gift; and
- taxes on financial and capital transactions, for example, stamp duties on conveyances and cheques.

This chapter compares Australia's property and transaction tax burden with the other OECD-10 countries over these four sub-categories. Information on the comparison across the OECD-30 is included in Chapter 3.

As for other areas where the OECD data are disaggregated finely, there are classification issues which mean that particular care needs to be taken in making comparisons across countries (and through time).

A wide variety of taxes fall into the property and transaction taxes category and there is considerable diversity between countries in the implementation and design of these taxes.

In Australia, virtually all taxes covered by this category are levied by the sub-national governments. In the other OECD-10 countries, the levels of government imposing these taxes differ. For the majority, sub-national governments are more reliant on these taxes than national governments as a source of revenue.

9.2 Broad international comparisons

As discussed in Chapter 3, Australia has a comparatively high reliance on property and transaction taxes (3.0 per cent of GDP) and is eighth highest of the OECD-30. In terms of the OECD-10, Australia's overall tax burden in this category is much closer to the unweighted average. Australia is fourth highest in terms of tax burden of the OECD-10 (see Chart 9.1).

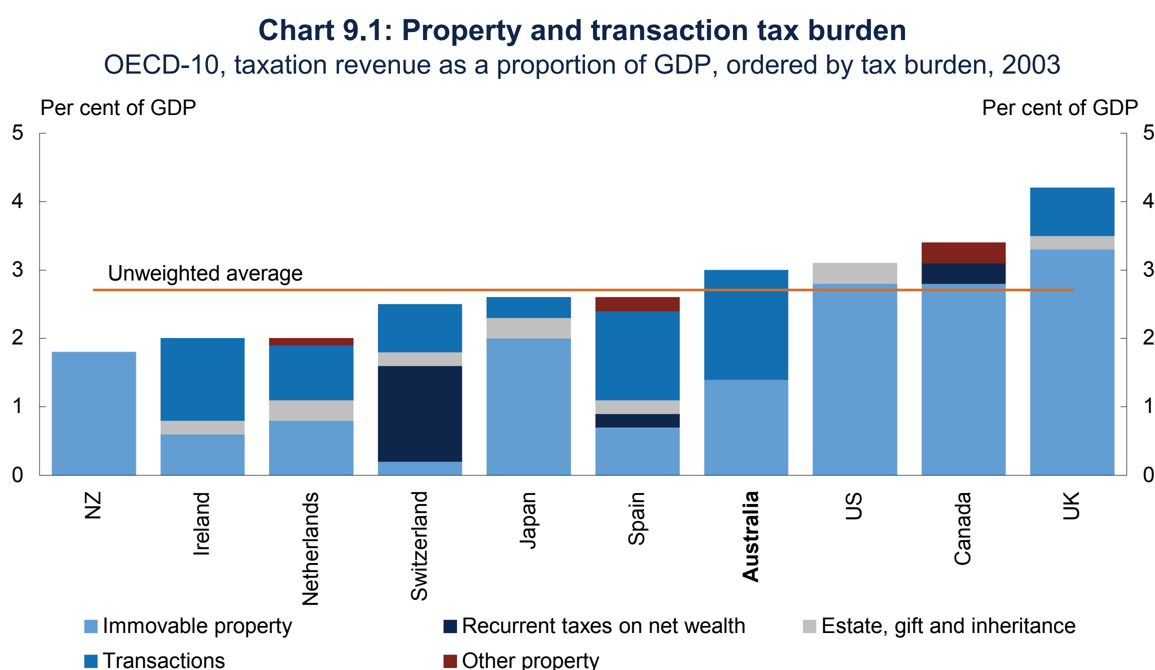


Chart 9.1: Property and transaction tax burden

OECD-10, taxation revenue as a proportion of GDP, ordered by tax burden, 2003

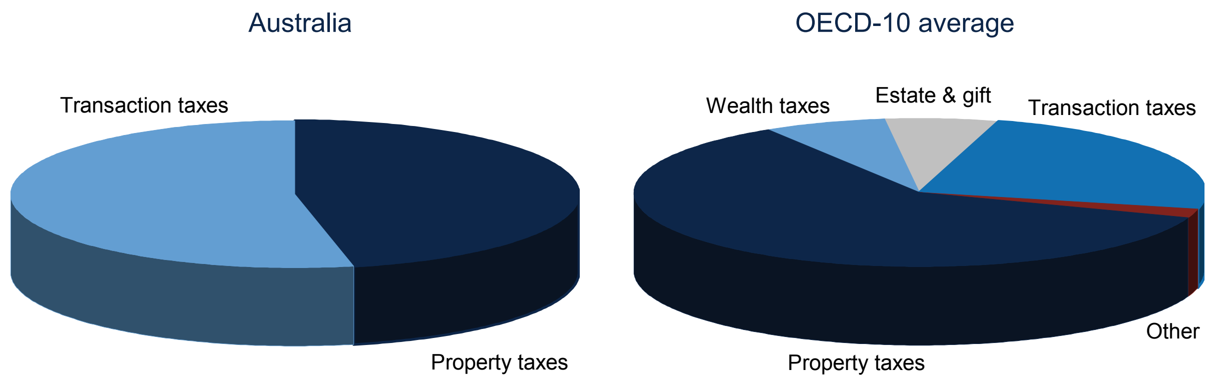
Source: OECD *Revenue Statistics*, 2005.

As is the case for all OECD countries, there is considerable diversity across the OECD-10 in the mix of property and transaction taxes.

As shown in Chart 9.2, the Australian mix is quite different from the average OECD-10 mix. Australia's proportion of the tax mix from immovable property taxes is below the average, whereas Australia's transaction tax burden is significantly above the average.

Australia does not have wealth taxes or estate, inheritance and gift taxes. The other OECD-10 countries all levy at least one of these types of taxes. (New Zealand imposes a gift tax, but the revenue collected from this tax is less than 0.01 per cent of GDP.)

Chart 9.2: Australia's property and transaction tax mix
OECD-10, 2003



Source: OECD *Revenue Statistics*, 2005.

9.3 RECURRENT TAXES ON IMMOVABLE PROPERTY

Recurrent taxes on immovable property are defined by the OECD as taxes levied regularly in respect of the use or ownership of immovable property. Usually, these taxes are levied on land and/or buildings.

In Australia's case, the majority of revenue under this category is from local government rates. Land taxes levied by State and Territory governments are also a significant component.

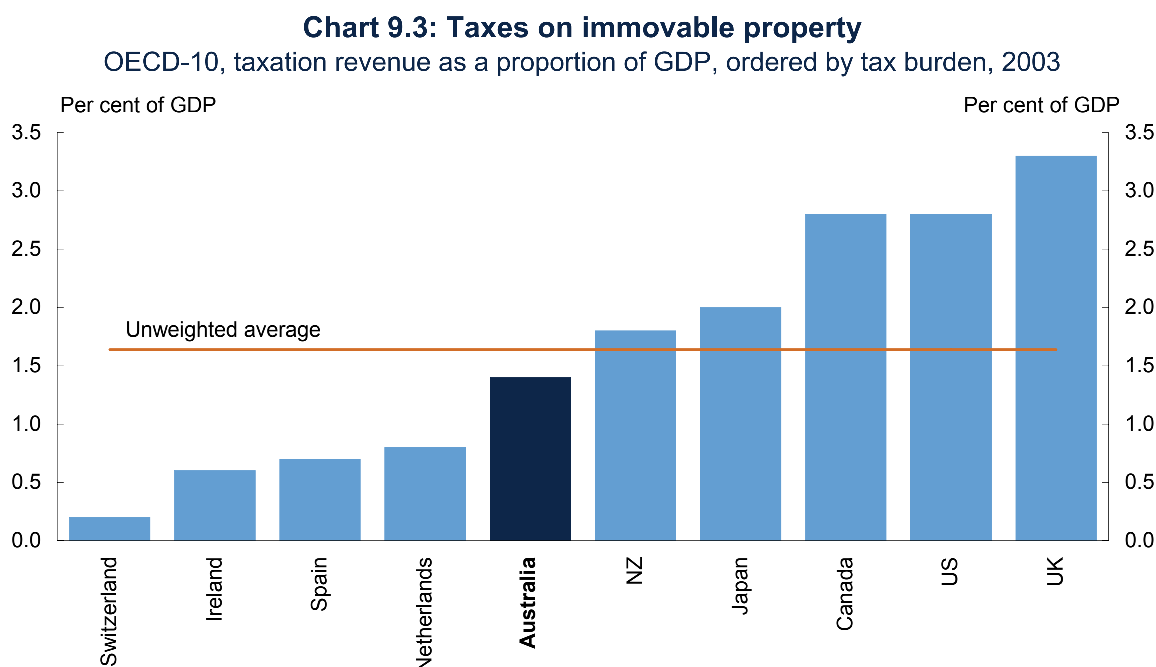
Taxes on immovable property do not include taxes on incomes flowing from property ownership (for example, rental income) or taxes on incomes flowing from the sale of property (for example, capital gains). These types of taxes are included in the relevant categories of income taxation revenue.

While Australia has the seventh highest immovable property tax burden (1.4 per cent of GDP) of the OECD-30, it is below the average of the OECD-10 (1.6 per cent).

Of the OECD-10, the United Kingdom has the highest reliance on immovable property taxes, and the United States, Canada, Japan and New Zealand are also relatively heavily reliant.

Chart 9.3: Taxes on immovable property

OECD-10, taxation revenue as a proportion of GDP, ordered by tax burden, 2003



Source: OECD *Revenue Statistics*, 2005.

Among the OECD-10, these types of taxes are generally levied by sub-national governments. As such, analysis of their characteristics is more difficult, because information on rates and bases is not as readily available and can vary widely within countries.

Table 9.1 summarises the number of these types of taxes levied in the OECD-10 and the different levels of government levying them. Table 9.2 summarises the tax bases used in the OECD-10. Comparable information on rates and bases is not readily available and the information in the following tables must be treated with caution as the detailed information has not been verified with the individual countries.

Table 9.1: Number of recurrent taxes on immovable property in the OECD-10 countries

	National government	State government	Local government
Australia	-	1	1
Canada	-	-	1
Ireland	-	-	1
Japan	-	-	3
Netherlands	-	-	1
New Zealand	-	-	1
Spain	-	-	1
Switzerland	-	1	-
United Kingdom	1	-	1
United States	-	1	1

Source: Various, see Chapter 1 (1.4.1).

Table 9.2: Immovable property tax bases utilized in the OECD-10 countries

	Land	Land and buildings/improvements	Buildings/improvements only
Australia	X	X	
Canada		X	
Ireland		X	
Japan		X	
Netherlands		X	
New Zealand	X	X	
Spain		X	
Switzerland(a)			
United Kingdom		X	X
United States(b)			

(a) Most canton levy land tax on the value of property as shown in the local land register.
(b) Methods for assessing the value of a property vary depending on the jurisdiction.
Source: Various, see Chapter 1 (1.4.1).

Appendix table 9.1.1 describes in more detail the various taxes levied on immovable property. Some of the key points that can be drawn from the analysis of these taxes are:

- the bases that the taxes are levied on and the bases of assessment vary between countries, between different taxes levied in a country and between different jurisdictions within countries; and
- exemptions are quite common and typically relate to how the property is used.

Overall, Australia's taxes on immovable property seem to be broadly comparable with many of the other OECD-10, but the OECD-10 overall tends to rely more on these taxes than the remainder of the OECD-30.

9.4 Recurrent taxes on net wealth

Recurrent taxes on net wealth are usually annual taxes based on a percentage of the taxpayer's financial and real assets after the deduction of financial liabilities.

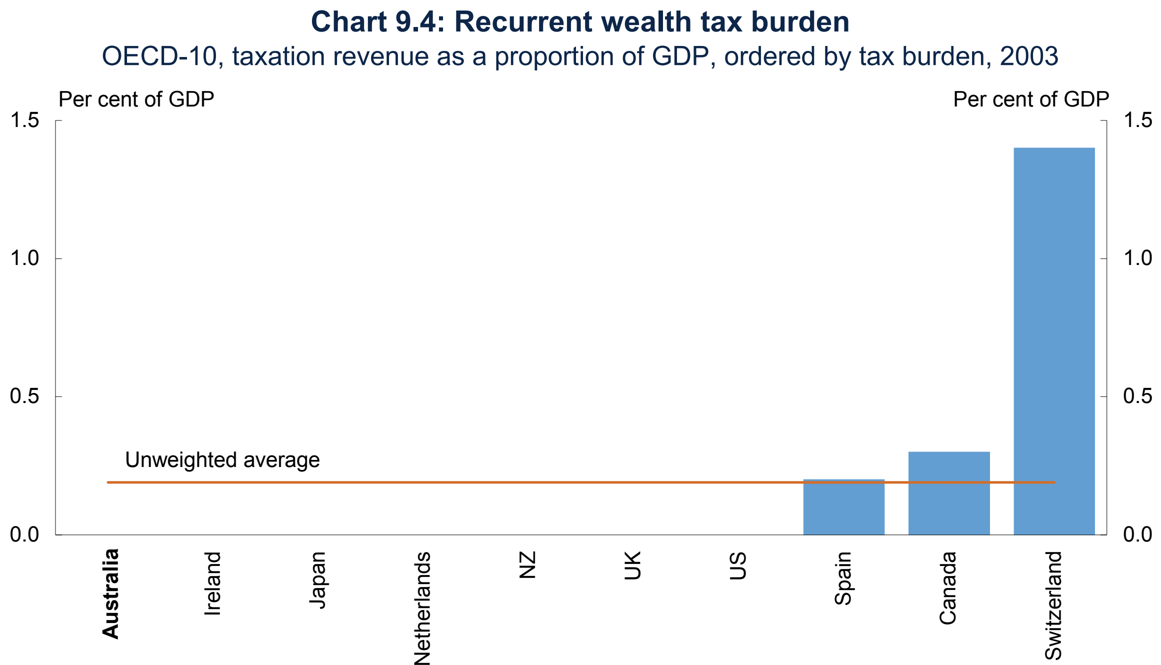
This type of tax is likely to have significant compliance costs for taxpayers requiring them to calculate annually the change in the total value of their assets and financial liabilities (such as outstanding loans). Records of these valuations and a system of verifying them are necessary.

Australia is one of seven OECD-10 countries that do not levy a recurrent net wealth tax. Only Canada, Spain and Switzerland levy this type of property tax.

Of these three countries, Switzerland relies the most heavily on these taxes (1.4 per cent of GDP), while for Canada and Spain they are a relatively small proportion of their tax mix.

Chart 9.4: Recurrent wealth tax burden

OECD-10, taxation revenue as a proportion of GDP, ordered by tax burden, 2003



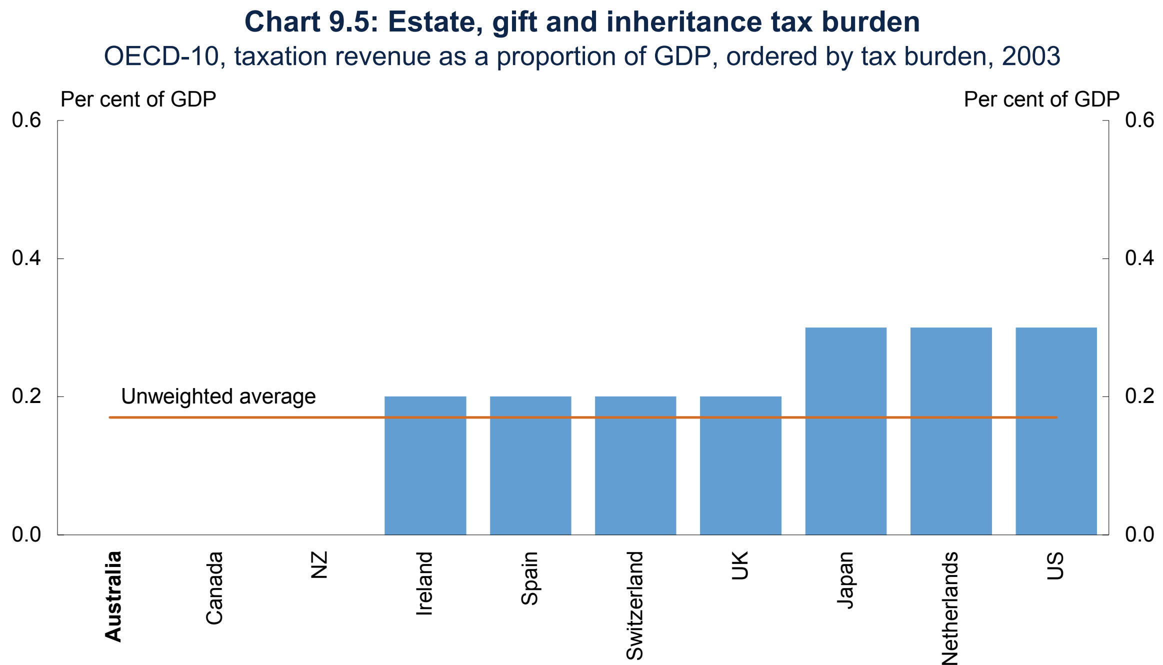
Source: OECD *Revenue Statistics*, 2005.

9.5 ESTATE, INHERITANCE AND GIFT TAXES

Australia is one of two OECD-10 countries that do not impose any estate, inheritance and gift taxes.

Of the OECD-10, Japan, the Netherlands and the United States rely most heavily on these taxes. Even for these countries, they are not a significant part of their tax base, accounting for around 0.3 per cent of GDP.

New Zealand collected approximately NZ$2 million from its gift tax in 2003, which is less than 0.01 per cent of its GDP.



Source: OECD *Revenue Statistics*, 2005.

In Canada, these taxes are not directly levied, but they are effectively imposed through deemed disposition provisions in income tax legislation.

Table 9.3: Summary of estate, inheritance and gift taxes in the OECD-10 countries

	Estate/Inheritance tax	Gift tax
Australia		
Canada(a)		
Ireland	X	X
Japan	X	X
Netherlands	X	X
New Zealand		X
Spain	X	X
Switzerland	X	X
United Kingdom	X	
United States	X	X

(a) While Canada does not levy any estate, inheritance or gift taxes, they are effectively imposed through deemed disposition provisions in income tax legislation.
Source: Various, see Chapter 1 (1.4.1).

Table 9.4: Tax rates and examples of exemptions/concessions

	Rates	Examples of exemptions/concessions applied
Australia	n/a	n/a
Canada	n/a	n/a
Ireland	20 per cent (Capital acquisitions tax).	Gifts between spouses, gifts and inheritances to charities.
Japan	Rates vary depending on the value of the gift/inheritance. Rates vary between 10 per cent-50 per cent (Inheritance tax and Gift tax).	Properties received by a person engaged in religious, charitable, scientific or other activities of public welfare.
Netherlands	Levied at a progressive rate and depend on the relationship between the donor/donee. Rates vary between 5 per cent-68 per cent (Inheritance tax and Gift tax).	Deductions are allowed for spouses and children.
New Zealand	Levied at a progressive rate, varying between 0 per cent-25 per cent (Gift duty).	Gifts of less than NZ$2,000 in a year, gifts to charities and gratuities.
Spain	Vary as levied by sub-national governments. The default rate for all regions varies from 7.65 per cent to 34 per cent depending on the taxable amount.	Deductions available for family members.
Switzerland	Varies between cantons — most cantons levy inheritance and gift taxes.	In Zurich (for example), spouses, same sex couples and descendants are exempt.
United Kingdom	Nil rate up to £275,000, 40 per cent for chargeable transfers and 20 per cent for chargeable lifetime transfers (Inheritance tax).	Transfers between spouses, donations to charity and political parties.
United States	Ranges between 18 per cent and 46 per cent depending on the taxable amount (Unified Estate and Gift Tax System).	Bequests to charities, unlimited marital deduction is allowed for bequests to a surviving spouse.

Source: Various, see Chapter 1 (1.4.1).

Appendix table 9.1.2 describes in more detail the estate, inheritance and gift taxes levied in the OECD-10 countries. Some of the key points from the analysis of these taxes are:

- estate, inheritance and gift taxes tend to be levied progressively in relation to the value of the inheritance/gift received;
- exemptions/deductions/concessions are common, especially for family members; and
- exemptions generally apply to donations made to organisations perceived to act in the public interest (that is, charities, religious organisations and government/political entities).

9.6 Taxes on financial and capital transactions

Taxes on financial and capital transactions are defined by the OECD as taxes on transactions such as:

- the issue, transfer, purchase and sale of securities;
- cheques; and
- specific legal transactions such as validation of contracts and the sale of immovable property.

In Australia, examples of such taxes would include stamp duties on residential conveyances, non-residential conveyances, mortgages, leases, shares, rental arrangements and other products.

Australia has the highest reliance on transaction taxes such as stamp duties on conveyances (1.6 per cent of GDP) of the OECD-10 (unweighted average of 0.7 per cent).

Of the other OECD-10 countries, Spain (1.3 per cent) and Ireland (1.2 per cent) also rely relatively heavily on these taxes compared to the other OECD-10 countries.

Again, as noted earlier, there are classification issues when the OECD tax data are disaggregated.

Some sub-national governments in both Canada and the United States impose taxes on the transfer of real estate, but revenues from these taxes are not reported under this sub-category.

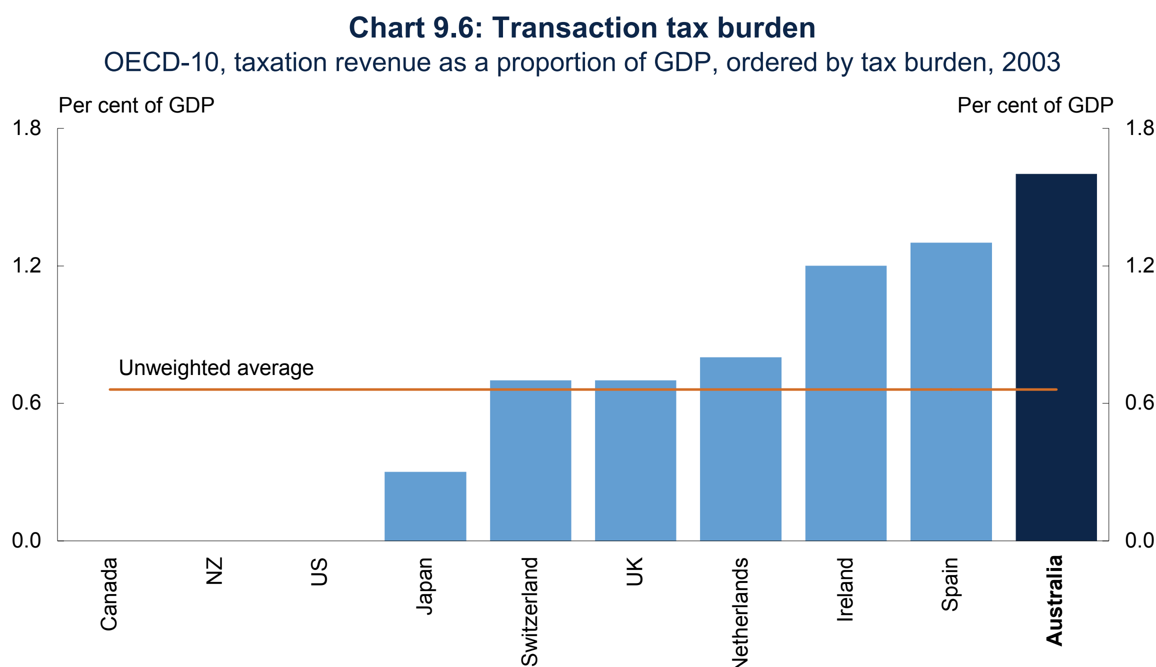
- For Canada, revenues from land transfer taxes are reported under the 'other (non-recurrent) property tax' category in the OECD's *Revenue Statistics 2005 Edition* (4520). Statistics Canada has advised that land transfer taxation revenue totalled C$1.9 billion in 2004 (around 0.1 per cent of GDP).

- For the United States, revenues from real estate transfer taxes are reported under another category in the OECD's *Revenue Statistics 2005 Edition* — 'recurrent taxes on the use of goods or on the permission to perform activities' (5213). Revenue collections from document and stock transfer taxes for state governments only were US$7.9 billion in 2004 (around 0.1 per cent of GDP).

New Zealand imposes two financial and capital transaction duties — cheque duty and an approved issuer levy (approved issuers are required to pay a levy for the right to issue securities that are subject to a zero rate of non-resident withholding tax). For 2003, New Zealand reported revenue collections of NZ$56 million (less than 0.1 per cent of GDP) under this sub-category.

Chart 9.6: Transaction tax burden

OECD-10, taxation revenue as a proportion of GDP, ordered by tax burden, 2003



Source: OECD *Revenue Statistics*, 2005.
Note: Revenues from Bank Accounts Debits tax (BAD tax) is included in the total figure for Australia. Under the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations*, all States and Territories abolished BAD tax by 1 July 2005 (New South Wales abolished BAD tax on 1 January 2002).

The most significant component of this category of taxes for Australia is the State and Territory stamp duties on conveyances (taxes on the sale of land and buildings).

- In 2003-04, around 80 per cent of the revenue from taxes on financial and capital transactions was attributable to stamp duties on conveyances for Australia. Revenue collections from stamp duties on conveyances vary with property values and with the level of market activity, so this revenue source can be subject to greater variability than other sources.
- Revenue from stamp duties on conveyances of real property makes up the majority of conveyance duty revenue collections for the Australian States and Territories.

Apart from New Zealand, all other OECD-10 countries levy taxes on the transfer of real estate.

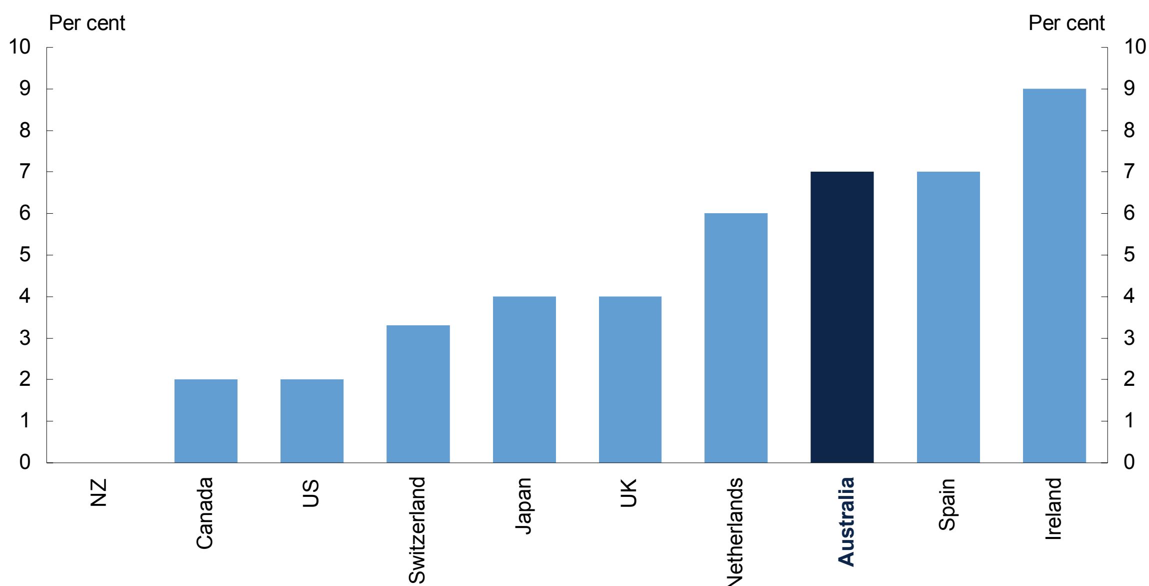
Appendix table 9.1.3 provides some details of these taxes in the OECD-10. Again, comparable information on these types of taxes is not readily available and the information in this table must be treated with caution as it has not been verified with the individual countries.

Table 9.5: Level of government levying taxes on the transfer of real estate

Australia	State
Canada	Provincial and Local
Ireland	National
Japan	National and Local (prefectures)
Netherlands	National
New Zealand	n/a
Spain	Local (Autonomous Communities)
Switzerland	Canton and Local (Communes)
United Kingdom	National
United States	State and Local (County)

Source: Various, see Chapter 1 (1.4.1).

Chart 9.7: Top tax rate applied on the transfer of real estate
OECD-10, 2005



Source: Various, see Chapter 1 (1.4.1).

Australia's top rate for stamp duty on conveyances (7 per cent) is the equal second highest of the OECD-10.

- The top conveyance duty rate of 7 per cent is the marginal rate applying to residential conveyances over A$3 million in New South Wales.

In addition to stamp duty on conveyances, the Australian States and Territories also levy a number of other financial transaction taxes, including stamp duties on mortgages, leases, shares and rental arrangements. Nearly all other OECD-10 countries also levy taxes on one or more of these transactions (Appendix table 9.1.4).

The goods and services tax (GST) was intended to replace a majority of these financial and capital transactions taxes in Australia. In 2005, the Australian Government proposed a timetable for the elimination of the remaining State and Territory taxes listed in the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations* (the agreement which provides for all GST revenue to be paid to the States and Territories).

- These taxes are stamp duties on mortgages, leases, cheques, shares, rental arrangements and business conveyances.

At the time of writing this report, complete agreement has not been reached between the Australian Government and all the States and Territories on the timetables for abolishing these taxes.

- Nonetheless, some States and Territories intend to abolish a number of these taxes over the next few years.

It is possible that in many OECD countries other general taxes, like VAT or capital gains tax, are applied to these transactions. For example, tax rates on the transfer of real estate in other countries might be quite low as other taxes that apply to the same base are relatively high, or taxes may be calculated on a VAT inclusive price. In addition, the interactions between these taxes could vary significantly from country to country and they have not been fully explored here. As a result, the total tax burden on financial and capital transactions may vary significantly from the revenue collections of financial and capital transaction taxes in OECD countries.

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APPENDIX 9.1: TAXES ON IMMOVABLE PROPERTY

Country	Tax	Rate	Base	Exemptions	Level of government	Other
Australia	Land tax	Rates are progressive and vary across jurisdictions.	Land — unimproved value.	A principal place of residence is generally exempt, as is land used for primary production. Land owned by religious bodies and schools.	State	Generally, liability rests primarily with the owner at a particular point in time.
	Rates	Vary across jurisdictions.	Varies across jurisdictions — land or land and improvements.	Vary across jurisdictions — common exemptions include publicly owned land, public hospitals, libraries, cemeteries, charities, church lands, universities, schools and foreign embassies.	Local	
Canada	Property tax	Rates vary by class of property and from municipality to municipality.	Land and improvements.	Exemptions include churches, cemeteries, Indian lands, public hospitals, charitable institutions and educational institutions.	Local	
Ireland	Rates	Fixed every year by local authorities as a multiple of the rateable value of the property.	Land and improvements — taxable value is based on annual rental value of the rateable property.	Domestic and agricultural property is outside the scope of the tax. Common exemptions include property used exclusively for the purpose of public religious worship, art galleries, museums, and libraries, property used for educational purposes, burial grounds or crematoriums.	Local	A local tax on the occupation of immovable property for non-residential is payable by the occupier.
Japan	Property tax	The standard rate is 1.4 per cent, maximum rate is 2.1 per cent.	Land, buildings and depreciable business assets. The tax base for land and buildings is their value assessed by municipalities, based on market prices.	Standard exemptions are available for land (of value up to ¥300,000) and housing (value up to ¥200,000). Property used as public roads or cemeteries, or for educational, religious, or social welfare is exempt.	Local	
	City planning tax	Maximum of 0.3 per cent.	Imposed on the owners of land and buildings located within an urban promotion area. Appraised value for property taxes is used.		Local	May be imposed by cities, towns and villages undertaking projects under the City Planning Law.
	Land development tax	At the discretion of local authorities.	Imposed on developers of land and is based on the developed area.		Local	

Appendix 9.1: Taxes on immovable property (continued)

Country	Tax	Rate	Base	Exemptions	Level of government	Other
Netherlands	Immovable property taxes	Rate differs for each municipality. Different rates may apply for commercial property and private property.	Land and improvements.	Exemptions include natural sites, public roads, public waterways, property mainly used for public worship, foreign embassies and consulates, public gardens, public parks, cemeteries, and crematoriums.	Local	The tax consists of: (1) a part levied on owners of immovable property; and (2) a part levied on the users of immovable property.
New Zealand	Rates	Varies depending on the type of rate imposed.	Varies — there are four systems of general rating. They include by capital (land and improvements) value, by unimproved land value, by the annual rental value of the property and by the area system.	Exemptions include property used for religious, charitable and educational purposes; heritage property; community land; and Maori and burial grounds.	Local	
Spain	Taxes on real estate	General tax rates are 0.4 per cent for urban property and 0.3 per cent for rural property, but higher rates may apply.	Land and buildings.	Exemptions include property owned by the church and Red Cross; diplomatic premises; schools.	Local	The taxable base is the cadastral value. The cadastral value is updated every eight years with reference to the market value of the property, including the value of land and buildings.
Switzerland	Land tax	Rates vary between 0.3 per cent and 4 per cent.	The application of the tax can vary across jurisdictions. Non-farm properties are usually assessed with respect to their market value, whereas farm and forestry properties measure their earning power.		Canton/Local	Primarily a communal (local) tax.
United Kingdom	Business rates	For the year ending 31 March 2006, the rate is 42.2 per cent in England (similar rates apply in Scotland and Wales).	Land and improvements (commercial only).	Exemptions include agricultural land and buildings; places of public worship; properties occupied by charitable and sporting organisations; and diplomatic premises.	National	The tax is payable by the occupier. Rateable values, which are assessed every five years, are currently based on market rents on 1 April 2003.

Appendix 9.1: Taxes on immovable property (continued)

Country	Tax	Rate	Base	Exemptions	Level of government	Other
United Kingdom (continued)	Council tax	Rates are set by each local government.	Buildings (residential only).	Exemptions include properties that are owned by charity, kept for occupation by ministers of religion, occupied by students; and occupied or managed by an educational establishment or charitable body.	Local	The tax is payable by the occupier.
United States	Real estate taxes	Varies across jurisdictions.	Methods for assessing the value of a property vary depending on the jurisdiction.		Local	

Source: Various, see Chapter 1 (1.4.1).

Appendix 9.2: Estate, inheritance and gift taxes

Country	Tax	Rate	Base	Exemption	Level of government	Additional information
Australia	Australia does not impose estate, inheritance or gift taxes.					
Canada	No Canadian jurisdiction imposes a gift or inheritance tax per se. They are effectively imposed through deemed disposition provisions in income tax legislation.					
	Deemed disposition through a gift	As per income tax rate.	A person who gifts property to another is deemed to have received proceeds equal to its fair market value. The deemed proceeds may cause the donor to recognise income, recaptured depreciation or capital gains.	Depends on the property involved. Also, a spouse may transfer property to the other spouse without attracting liability.		
	Deemed disposition through death	As per income tax rate.	Similar to above. The deceased is deemed to have disposed of all property owned immediately before the time of death. Note that deemed capital gain is only the increase in value of assets, not the total value.	A spouse may transfer property to the other spouse without attracting liability.		
Ireland	Capital acquisitions tax	A single rate of 20 per cent, which applies to any accumulated gifts and inheritances over the relevant class threshold.	Levied on the receipt of gifts, or on the successor of property passing on death. The taxable value is the market value on the date of the gift or succession.	A number of exemptions including, but not limited to, gifts passing between spouses, gifts and inheritances to charity; small gifts up to €1,270 per year, gifts and inheritances of life insurance policies.	National	

Appendix 9.2: Estate, inheritance and gift taxes (continued)

Country	Tax	Rate	Base	Exemption	Level of government	Additional information
Japan	Inheritance tax	Between 10 per cent and 50 per cent depending on the size of the inheritance.	Imposed on the total value of all properties acquired through an inheritance or a bequest (less liabilities and funeral expenses). Valuation of properties is based on market price.	Exemptions include, but are not limited to, life and personal accident insurance proceeds; retirement and similar benefits; and properties received by a person engaged in religious, charitable, scientific or other activities for public welfare.	National	Gifts within three years before death are included in the taxable base, but any gift tax payable is credited against the inheritance tax.
	Gift tax	Between 10 per cent and 50 per cent depending on the size of the gift.	Imposed on property given as a gift.	Exemptions include, but are not limited to, gifts from a corporation; sums received by dependants for living and educational expenses; properties received by a person engaged in religious, charitable, scientific or other activities for public welfare; and political contributions.	National	
Netherlands	Succession duty	Levied at a progressive rate (between 5 per cent and 68 per cent) depending on the proximity of the relationship between the deceased/donor and the value of the inheritance.	Imposed if property is acquired by inheritance or by gift and the deceased/donor was/is a resident of the Netherlands.	Deductions are allowed for spouses and children. Gifts to certain museums.	National	Levied on the beneficiary/donee.
New Zealand	Gift duty	Marginal rates range from 0 per cent to 25 per cent depending on the value of the gift.	Payable on gifts of all property in New Zealand and gifts of property situated outside New Zealand if the donor is domiciled in New Zealand.	Exemptions include, but are not limited to gifts of less than NZ$2,000 in aggregate for one calendar year; gifts to maintain education of relatives; gifts to charities and gratuities.	National	
Spain	Inheritance and gift tax	Varies depending on region. The default rate for all regions varies from 7.65 per cent to 34 per cent depending on the taxable amount.	Transferred assets are valued at their fair market value.	Deductions available for family members.	Autonomous communities	A recipient who is a resident of Spain is liable to this tax with regard to property in Spain or abroad, acquired through a gratuitous transfer. Non-residents are subject to this tax with regard to any assets located in Spain.

Appendix 9.2: Estate, inheritance and gift taxes (continued)

Country	Tax	Rate	Base	Exemption	Level of government	Additional information
Switzerland	Inheritance and gift taxes	The effective tax burden varies between cantons, but usually is based on the degree of relationship and/or the received amount. Rates range from 10 per cent to 50 per cent.	For tax purposes, there is generally no distinction between inheritances and gifts. The right to levy inheritance and gift taxes on movable property is left to the canton in which the descendant had their last residence, and to the canton in which the donor has their residence, respectively.	For example, in the canton of Zurich, spouses, same-sex couples and descendants are exempt.	Cantons	Most cantons levy inheritance and gift taxes.
United Kingdom	Inheritance tax	A nil rate applies up to £275,000. Above this amount, the rate is 40 per cent for chargeable transfers and 20 per cent for chargeable lifetime transfers.	Levied on the transfer of all property passing on death (chargeable transfers).	Exemptions include, but are not limited to, transfers between spouses, regular gifts, gifts up to £3,000 in a tax year, and donations to charity and political parties.	National	It is also levied on certain gifts made within the seven years before the death of a person. It is levied on worldwide property of domiciled individuals and trusts. Non-domiciled individuals are liable to tax only on assets situated in the United Kingdom.
United States	Unified Estate and Gift Tax System	Ranges between 18 per cent and 46 per cent depending on the taxable amount.	Levied on the accumulative total value of all transfers made by an individual during life and at the time of death. Applies to all United States citizens and foreign nationals who are United States residents at the time of death. Applies also to non-residents on property that is deemed to have a United Stated location. Property is valued at the fair market value at time of death.	The value of the gross estate is reduced by: (1) expenses and losses; (2) mortgages and indebtedness; (3) certain taxes imposed by United States states or foreign countries on transfers made for public, charitable or religious purposes; and (4) bequests to charities. Also, an unlimited marital deduction is allowed for bequests to a surviving spouse. An exclusion applies to gifts up to the value of US$12,000 per donee in one year.		Also imposes a generation skipping transfer tax (GSTT) on transfers made to beneficiaries who are more than one generation younger than the donor. Note: the estate tax and GSTT are scheduled to be completely phased out by 2010.

Source: Various, see Chapter 1 (1.4.1).

APPENDIX 9.3: TAXES ON THE TRANSFER OF REAL ESTATE

Country	Top rate[a]	Progressive rate structure	Examples of exemptions[b]	Level of government	Additional information
Australia	7 per cent	Yes	First home owners can receive discounts/exemptions for lower valued properties.	State	Rates vary across States and Territories, maximum rates vary from 3.75 per cent to 7 per cent. The maximum rate of 7 per cent is for transfers over A$3 million in New South Wales.
Canada	2 per cent	Yes (generally)	In Ontario, for example, a refund is available for first time purchasers of a newly constructed home.	Provincial/Local	Rates vary across provinces (six provinces impose land transfer taxes). A few provinces levy registration fees rather than transfer taxes.
Ireland	9 per cent	Yes	First home owners are exempt for low to mid-cost houses.	National	Rates vary for different definitions of purchasers. The maximum rate of 9 per cent is for transfers over €635,000 for all purchasers.
Japan	4 per cent	National: various flat amounts depending on value. Prefecture: flat 4 per cent.	Exemptions below threshold levels.	National/Prefecture	
Netherlands	6 per cent	No	Exemptions for acquisitions by children, acquisitions by public organisations, agricultural land and buildings.	National	
New Zealand	-	-	-	-	-
Spain	7 per cent	No	First sale of property (VAT is applied instead).	Autonomous communities	
Switzerland	3.3 per cent			Canton/Local	A few cantons levy transfer fees rather than transfer taxes.
United Kingdom	4 per cent	Yes	Exemption for non-residential land in disadvantaged areas.	National	Higher tax free thresholds for residential property in disadvantaged areas.
United States	2 per cent	Mixture of progressive and flat structure.		State/Local (County)	

(a) Top rate across all jurisdictions levying such a tax.
(b) Does not cover all exemptions/concessions.
Source: Various, see Chapter 1 (1.4.1).

APPENDIX 9.4: EXAMPLES OF OTHER FINANCIAL AND CAPITAL TRANSACTION TAXES

Country	Other types of transactions taxed
Australia	Mortgages, leases, share transfers, rental arrangements
Canada	No examples could be found
Ireland	Mortgages, leases, share transfers
Japan	Transfer of mining rights, intangible property rights, leases, shares, debentures, promissory notes
Netherlands	Share transfers
New Zealand	Cheques
Spain	Deeds, leases, moveable assets
Switzerland	Shares and other financial instruments
United Kingdom	Other main stamp duties beside stamp duty on property transfer, are on leases and share transactions
United States	Some States levy taxes on mortgages, car hire

Source: Various, see Chapter 1 (1.4.1).

Chapter 10

International taxation arrangements

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10. International taxation arrangements

Summary

Australia's international taxation arrangements are consistent with OECD practice and the other OECD-10 countries in the following areas:

- the application of its domestic taxation system to cross-border investment and transactions (inbound and outbound);
- the taxation of temporary residents[1]; and
- the taxation of dividends, interest and royalties paid to non-residents, although some countries have zero withholding tax rates on these payments, while others have extended withholding taxes to a broader range of non-resident income.

In some areas, Australia's international taxation arrangements differ, for example:

- Australia's treatment of the capital gains of non-residents and foreign losses[2]; and
- Australia has an extensive foreign business income exemption for its companies and does not tax foreign business income flowing through Australian companies to foreign shareholders.

The extent of Australia's attribution rules, which prevent residents accumulating passive income (such as dividends and interest) in non-resident entities in low-tax countries to defer Australian tax, is broadly similar to those in other OECD-10 countries. Australia also has other international tax integrity rules, as do the rest of the OECD-10.

10.1 Introduction

International tax arrangements involve modifications to the normal rules of a country's domestic income tax system where they interact with the tax system of another country as a result of cross-border investments or transactions. They form part of the personal and corporate tax bases and seek to enhance the economic benefits derived from cross-border activities (or limit the economic costs of them). The balance between the costs and benefits of cross-border activities and the consequent international tax rules may vary depending on the circumstances of a particular country.

---

1 The Australian Government announced in the 2005-06 Budget (and has recently introduced legislation to Parliament) measures to align more closely its tax treatment of temporary residents to that of other countries.

2 Reforms announced in the 2005-06 Budget will address these areas and bring Australia into line with other OECD-10 countries.

- For example, inbound foreign direct investment may be valued more highly by a net capital-importing country than by a net capital-exporting country. As a result, the capital-importing country may decide to modify its domestic tax law to a larger degree to accommodate this type of activity (for example, reduce the non-resident withholding tax rate or base). Conversely, if it is in need of more revenue and it perceives its inbound investments as being sufficiently profitable, then it may choose to increase the source taxation on those inbound investments (for example, increase the non-resident withholding tax rate or base).

To compare international tax arrangements, it is necessary to consider the basis on which tax is levied — the residence of the taxpayer or the source of the income. This chapter considers 'residence' and 'source' for international tax purposes (to tax foreign source income), and compares tax residence rules for both natural and legal persons across the OECD-10. It goes on to look at the tax treatment of foreign source income, firstly for individuals (including for temporary residents) and then for companies. It then compares the foreign tax credit (FTC) systems (with a company focus) across the OECD-10.

The tax treatment of the income of non-residents, including conduit income (for example, foreign business income earned by a resident company and distributed to non-resident shareholders), is then considered, followed by commonly used international tax integrity rules. The chapter concludes with a comparison of tax treaty networks and features across the OECD-10.

Box 10.1: Australia and the Review of International Taxation Arrangements (RITA)

Australia recently reviewed many of its international tax arrangements (and continues to implement recommendations/commitments from the review, including the changes announced in the 2005-06 Budget). The review focused on ensuring that, in an increasingly integrated global business environment, Australia's tax system was not hindering its attractiveness as a place for multinational business and investment. One of the key outcomes was the reduction in, and streamlining of, Australia's taxation of inbound, outbound and conduit investment. By doing so, it will potentially raise the attractiveness of outbound investment and regional headquarter activity from Australia, increase its attractiveness to inbound foreign investment and help reduce its cost of capital.

Ensuring that international tax arrangements are not discouraging these cross-border investments is a key focus for many countries, including Australia.

10.2 Residence

Generally, countries tax both residents and non-residents on domestic source income. Tax residence rules usually extend the taxation of residents to their foreign source income.

- Residence is an international tax law construct used to tax the legal and natural persons of a country on their foreign source income. Without such a construct, a country would only be able to tax these persons on their domestic source income (see Box 10.2).

As a result, only resident taxpayers tend to be taxed on their worldwide income whereas non-resident taxpayers are generally only taxed on their domestic source income

(see Box 10.3). Some countries have a territorial tax system which only taxes income arising within their own borders, irrespective of the residence of the taxpayer. Key reasons for taxing the foreign source income of residents are to achieve horizontal and vertical equity goals, and to improve the tax neutrality of investment decisions (efficiency).

Box 10.2: Residency rules

All countries have residence tests for both natural persons (individuals) and legal persons (companies). These tests can be based on legal form and/or economic form (substance).

The tax residence of individuals is usually based on either: physical presence in the country (legal form, such as citizenship); facts and circumstances that prove residence in a country (economic substance, such as the country where the person has a fiscal presence); or a combination of the two. In many cases, this may be satisfied simply by being present in a country for a set period of time, such as 183 days.

The tax residence of companies (that is, where companies are established or carry on business) is usually based on either place of incorporation (legal seat), location of management (real seat) or a combination of the two.

Residency rules have an important role to play in tax treaties as they clarify the right to tax and assist in the avoidance of double taxation.

Box 10.3: Source rules

Broadly, source rules operate to identify income arising within a country's geographical boundaries.

The term 'source' is not defined in Australia's tax legislation. Australia's source rules are derived from a combination of common law, statutory provisions and Australia's tax treaties. For example, Australia has statutory source rules which identify profits arising from certain import and export sales as having an Australian source.

The common law has developed a range of principles which operate in the absence of statutory provisions. Whether or not the income will be seen to be sourced in Australia under the common law principles is a question of fact in the circumstances of the particular case.

In addition, Australia is largely unique in the world in that its tax treaties contain source rules that empower Australia to exercise taxing rights that are allocated to it by the treaty even when domestic law may not otherwise provide source country taxing rights.

International practice varies as to the nature and extent of the source rules. Generally, countries use geographical boundaries, types of income, or a mixture of both to determine the extent to which they will seek to tax income sourced in their jurisdiction.

Table 10.1 shows for the OECD-10 the basis of the residence test for both individuals and companies.

Table 10.1: Residence tests for individuals and companies

Country	Tax residence test — individuals	Tax residence test — companies
Australia	Facts and circumstances; in practice, high reliance on time present. Individuals deemed a resident if they spend more than one-half of the income year in Australia (unless they can establish a usual place of abode outside Australia and no intention to take up residence).	A company is an Australian resident if it is incorporated in Australia, or carries on business in Australia and has either its voting power controlled by resident shareholders or its central management and control in Australia.
Canada	Facts and circumstances; in practice, high reliance on residential ties. Individuals deemed a resident for entire year if they sojourn to Canada for 183 days or more.	A corporation is a Canadian resident if it is either managed and controlled, or incorporated, in Canada.
Ireland	Facts and circumstances; in practice, high reliance on time present. Individuals deemed a resident if they spend 183 days or more in Ireland during the tax year. Also deemed a resident if they spend 280 days in that year and the previous year taken together in Ireland.	A company is an Irish resident if it is managed and controlled in Ireland. All new companies incorporated in Ireland are regarded as resident for tax purposes, however this does not apply to a company if: (1) it (or a related company) carries on a trading activity in Ireland, and: (i) it is under the control of persons resident in an EU member state or in a treaty country; or (ii) is (or is related to a company which is) quoted on an EU or treaty country stock market; or (2) it is regarded under a tax treaty as being a resident in a treaty country and not resident in Ireland.
Japan	Facts and circumstances; in practice, high reliance on time present. An individual is a resident if they have a domicile or have maintained a residence in Japan continuously for one year or more. Residents are either permanent or non-permanent (non-permanent if they do not intend to stay in Japan, unless they continued to maintain a domicile or residence for more than five years). A permanent resident is a resident other than a non-permanent resident.	A company is a Japanese resident if it is incorporated, or has its head office, in Japan.
Netherlands	Facts and circumstances; in practice, high reliance on personal and economic ties (especially the centre of economic and social interests). No time limits are mentioned as an indicator of residence.	Company is treated as resident in the Netherlands if: (1) it is incorporated under Dutch law, generally as an NV (public limited) or BV (private limited) company; or (2) it is actually situated in the Netherlands. A principal criterion is the location of the company's central management.
New Zealand	Facts and circumstances; in practice, high reliance on time present. Deemed a resident if present in New Zealand for an aggregate of 183 days or more in any 12-month period. Also resident if an individual has a permanent place of abode in New Zealand (social and financial associations are relevant here).	A company is a New Zealand resident if it is incorporated in New Zealand, it has its head office in New Zealand, its centre of management is in New Zealand or the directors (acting as directors) exercise control of the company in New Zealand. The head office of a company means the centre of its administration management.
Spain	Time present in Spain, and centre of vital economic and business interests are main factors. A person will be resident in Spain if they stay there for more than 183 days in any calendar year.	A company is a Spanish resident if it is incorporated in Spain, has its registered office in Spain or has its place of management there.
Switzerland	Facts and circumstances; in practice, high reliance on time present. Deemed a resident if carrying on gainful activity in Switzerland for more than 30 days or if in Switzerland for more than 90 days (without a gainful activity). The centre of an individual's personal and economic interests is also decisive.	A company is a Swiss resident if it is incorporated, or if its place of effective management is, in Switzerland.

Table 10.1: Residence tests for individuals and companies (continued)

Country	Tax residence test — individuals	Tax residence test — companies
United Kingdom	Facts and circumstances; in practice, high reliance on time present. Individual regarded as a resident for an income tax year if they spend an aggregate of 183 days in the United Kingdom for that tax year, or if habitually visiting the United Kingdom for more than 91 days or more in four consecutive years (residence from the fifth year). There is also strong reliance on the maintenance of a permanent home in the United Kingdom.	A company is a United Kingdom resident if its central management and control is in the United Kingdom, or it is incorporated in the United Kingdom.
United States	Time present in the United States, lawful permanent residence and citizenship. An individual is treated as a resident of the United States under the substantial presence test for a calendar year if: they spend 31 days or more in the United States; or if the sum of the days present in the United States during the current year, plus one-third the number of days present in the first preceding calendar year, plus one-sixth the number of days present in the second preceding year, equals 183 days or more.	A company is a United States resident if it is incorporated under the laws of any State in the United States.

Source: Various, see Chapter 1 (1.4.1).

Most of the OECD-10, including Australia, supplement their residence tests for both individuals and companies with substance-based tests. Without these tests, individuals and companies may be able quite easily to reduce or avoid worldwide income taxation by migrating (in legal form) to a low-tax country without their underlying economic circumstances changing.

For individuals, the majority of the OECD-10, including Australia, have a residence test based upon the facts and circumstances of the case. The most common factor appears to be time present in the country. Most countries consider that around six months (183 days) is sufficient to establish residency unless there are other facts to suggest otherwise regardless of time spent.

For companies, only the United States relies solely on the incorporation test to establish residence.[3] All other countries in the OECD-10, including Australia, have some form of management or control test as a part of their company residence test.

10.3 Treatment of foreign source income

10.3.1 Treatment of an individual's foreign source income

As noted, resident individuals are generally taxed on their worldwide income while non-resident individuals are generally only taxed on their domestic source income. But some individuals have features of both residents and non-residents. A common example is foreign long-stay individuals, often referred to as 'temporary residents' or 'expatriates', who may work in a country for more than half a year (when they might ordinarily become residents)

3 The United States has experienced some difficulties in recent times with resident companies migrating in legal form to low-tax countries in part because of such a black and white test.

but are not permanent (for example are on work visas — quasi-non-resident). Many countries specifically cater for these individuals by not taxing them on their worldwide income unless their temporary nature becomes permanent (however determined). These rules are intended to improve the attractiveness of countries to internationally mobile labour.

Table 10.2 shows for the OECD-10 what constitutes temporary residence and compares the tax treatment of their income with that of ordinary resident and non-resident individuals.

Table 10.2: Comparing tax treatment of temporary residents (expatriates) with resident and non-resident individuals

Country	Key temporary residence rules (expatriates)	Liability to tax	Tax rates	Tax base (including social security contributions/obligations of employees and employers)
Australia(a)	No specific rules exist for temporary residents. There are some exemptions for short-term and 'exempt' visitors.	Residents: worldwide income. Expatriates: there is no separate category of temporary residents, so liability to tax depends on status as resident or non-resident. There is a limited exemption for 'exempt visitors' from the foreign investment fund rules for four years provided they are holders of a temporary visa. Also an exemption from the CGT deemed disposal rule (which applies when residents become non-residents) for short-term residents (that is, individuals who have only been residents for less than 5 of the past 10 years) on pre-residence or bequeathed assets. Non-residents: Australian source income.	Income: residents are taxed at reduced rates, compared with non-residents, at incomes less than A$21,600. Capital gains: other than difference in rates referred to above, no difference between non-residents and residents (capital gains are aggregated with income).	Income: minor relief for support of dependants available to residents. Medicare (compulsory medical insurance system) rights and obligations are not applicable to non-residents. Capital gains: comprehensive (residents) Australian land, business assets and direct interests in Australian entities (non-residents). Expatriate treatment of capital gains will depend on whether they are considered a resident or non-resident. Gains are included in taxable income, and therefore potentially subject to different rates as between residents and non-residents.

Table 10.2: Comparing tax treatment of temporary residents (expatriates) with resident and non-resident individuals (continued)

Country	Key temporary residence rules (expatriates)	Liability to tax	Tax rates	Tax base (including social security contributions/obligations of employees and employers)
Canada	None	Residents: worldwide income. Expatriates: n/a. Non-residents: Canadian source income.	Income: no difference between residents and non-residents. Capital gains: no difference between residents and non-residents.	Income: minor relief for support of dependants available to residents. Canada has a provincial medical insurance system. The method of funding varies from province to province. Compulsory medical insurance system rights and obligations are not applicable to non-residents. Employees and employers must contribute to the employment insurance fund. The maximum contribution for an employee is C$729 and for employers C$1,021 (employee contributions are C$1.87 and employer contributions are C$2.62 per C$100 of Insurable earnings); maximum Insurance earnings is C$39,000. Access to most social programmes is restricted to residents. Canadian pension plan contributions are required on annual earnings (as at 2005) exceeding C$3,500 (to max of C$41,100); contribution rate is 4.95 per cent of such earnings (split between employer and employee). Some jurisdictions in Canada impose a formal payroll tax (Newfoundland, Manitoba, Quebec, Ontario, the Northwest territories and Nunavut). Capital gains: comprehensive (residents) Canadian land, Canadian business assets and direct interests in Canadian companies and trusts (non-residents).
Ireland	Resident, but not ordinarily domiciled in Ireland.	Residents: worldwide income. Expatriates: income from an Irish source and United Kingdom employment and other foreign source income remitted to Ireland. Non-residents: Irish source income.	Income: non-residents are not entitled to potentially lower rates associated with joint assessment. Capital gains: no difference between residents and non-residents.	Income: non-residents are not taxed on interest from government securities. Residents are able to claim interest deductions (capped) on home loans used for a principal residence; non-residents unlikely to have Irish principle residence. All Irish residents are entitled to certain basic health care services. All employees and self-employed individuals other than medical card holders must pay a health contribution levy of 2 per cent of their gross earnings (if annual income is at least €22,880). In terms of social security, all employed and self-employed individuals and employers contribute to the social welfare fund (employers 10.75 per cent on all income; employees 4 per cent on income up to €46,600 (from 2006); self-employed approximately 3 per cent on all income). Social security contributions are not deductible against income. These benefits are largely limited to residents. Capital gains: comprehensive (residents). Comprehensive, but foreign gains only taxed on remittance basis (expatriates). Irish land, Irish business assets and shares in Irish land or business asset rich non-listed companies (non-residents).
Japan	Residents who do not intend to live permanently in Japan, and do not stay for more than five years in any 10-year period.	Residents: worldwide income. Expatriates: Japanese source income and foreign source income remitted to Japan. Non-residents: Japanese source income.	Income: residents are taxed at progressive rates up to 37 per cent (if not a permanent resident, 50 per cent). Non-residents are taxed at a flat rate of 20 per cent. Capital gains: residents taxed at 14-39 per cent (depends on type of gain). Non-residents usually taxed at flat rate of 10 per cent.	Income: non-residents are not entitled to a basic deduction of ¥380,000. Expatriates are entitled to tax free relocation and annual home leave allowances. It is compulsory for an employee or self-employed individual in Japan to join the three social insurance schemes: health, pension, and employees insurance. Health and pension insurance schemes are payable monthly by the employee and employer in equal amounts. Any contributions made by an individual will be deductible for income tax purposes. For expatriates, only Japan sourced payments are chargeable and only if payroll operated in Japan. Capital gains: comprehensive (residents and expatriates); Japanese rights/licences, direct interests in Japanese companies, Japanese businesses and certain securities (non-residents).

Table 10.2: Comparing tax treatment of temporary residents (expatriates) with resident and non resident individuals (continued)

Country	Key temporary residence rules (expatriates)	Liability to tax	Tax rates	Tax base (including social security contributions/obligations of employees and employers)
Netherlands	Expatriates working in the Netherlands with a Dutch company with scarce specific expertise. A time limit of up to 10 years applies (although after five years the tax administration may require proof that expatriate still has the specific know-how).	Residents: worldwide income. Expatriates: either resident or non-resident treatment, at expatriate's election. Non-residents: Dutch source income.	Income: no difference between residents and non-residents. Capital gains: no difference between residents and non-residents.	Income: expatriates can receive 30 per cent of their salary and wages tax free for a maximum of 10 years. Certain personal allowances, minor relief for support of dependants and income-splitting are not available for non-residents. Both employees and other residents are obliged to pay social security premiums under the national social security scheme (approximately 32 per cent of taxable income up to €30,357; people over 65 pay approximately 14 per cent). There is also an additional obligatory social security scheme which covers employees only (premiums apportioned to both employers and employees). Non-residents: EU nationals who come to the Netherlands to work on a temporary basis can apply for a one or two year exemption from paying national social security premiums on the basis of EU legislation. This exemption is available for other non-residents as well if Netherlands has a social security treaty with their home country. As of 2006 a new health care insurance system exists (to replace the old dual scheme). The premium will be 6.5 per cent of salary with a maximum of €1,951. The same treatment exists for residents and non-residents. An unemployment insurance contribution is levied at a rate of approximately 5.2 per cent on annual income between €15,138 and €43,848 (the contribution is deductible). Capital gains: no difference between residents and non-residents.
New Zealand	New Zealand is in the process of amending its laws so that first-time (or first time in 10 years) residents who come to New Zealand for work will be exempt on foreign income other than dividends, interest, employment income and service business income. Limit of five years (or three if not employed on arrival).	Residents: worldwide income. Expatriates: if amendments are passed, foreign source income other than dividends, interest, employment income and service business income will be exempt. Non-residents: New Zealand source income.	Income: no difference between residents and non-residents. Capital gains: no capital gains tax.	Income: minor relief for support of dependent children available to residents. There is no compulsory health or social security insurance. There is a comprehensive accident compensation scheme administered by Accident Compensation Corporation, funded by levies on employers and employees, and self-employed individuals. Levies payable are based on earnings and collected through the PAYE system. The fund pays out for 'accident-related' medical services and for loss of earnings. Capital gains: no capital gains tax.

Table 10.2: Comparing tax treatment of temporary residents (expatriates) with resident and non resident individuals (continued)

Country	Key temporary residence rules (expatriates)	Liability to tax	Tax rates	Tax base (including social security contributions/obligations of employees and employers)
Spain	Individuals (expatriates) who move their residence to Spain to work may opt to be taxed under the Spanish income tax as non-residents.	Residents: worldwide income. Non-residents: Spanish source income.	Income: residents are taxed at progressive rates up to 45 per cent. Non-residents are taxed at flat rate of 25 per cent without deductions or allowances (temporary work is only taxed at 2 per cent). Expatriates: may elect to be taxed as residents (that is, the progressive rates above with certain expenses deductible) or as non-residents (flat rate of 25 per cent, but no deductions) in the tax year they move to Spain and for the next five years. Capital gains: residents are taxed at 15 per cent flat rate. Non-residents are taxed on long-term gains (assets held for more than one year) generally at a rate of 35 per cent.	Income: exempt income for residents includes: indemnities for physical/mental damages; mandatory compensation for termination of employment; disability pensions; child support payments. Deductions allowable for social security contributions and contributions to private pension schemes (non-residents not entitled to these). All *resident* employed and self-employed individuals must pay monthly contributions to the social security system, which consists of a general contribution system and a special contribution scheme. The general system divides employees into professional categories to determine their social security contribution. The general contribution system has a minimum and maximum contribution base that is adjusted annually. For 2006, the maximum monthly base is approximately €2,897.70. Compulsory social security contributions are deductible for individual income tax purposes. Capital gains: there are short-term gains (assets held for one year or less) which are taxed as income, and long-term gains which are subject to a separate capital gains tax (15 per cent). Exemptions exist for individuals’ primary residence.
Switzerland	Expatriates are entitled to certain deductions. Expatriates are executives or specialist who are assigned to Switzerland for a period not exceeding five years (as soon as intention to stay for less than five years changes the deductions are no longer available. They are not denied retroactively).	Residents: ‘inland income’ (generally includes all worldwide sources of revenue from moveable property). Non-residents: Swiss sourced income.	Income: the same tax rates are applicable for non-residents as for residents. Resident immigrants: special rates apply on passive income for a limited period from immigration. Capital gains: no difference between residents and non-residents (Swiss business capital gains are treated as income).	Income: no difference between residents and non-residents. Expatriates may claim specific deductions according to ’sub-national and national’ law (for example costs for housing, moving, and travelling). Health insurance is mandatory, but is also the responsibility of the individual (premiums vary depending on the insurance company and age of the individual). Non-residents are not subject to the minimum medical insurance. In terms of social security, employers withhold employees’ contributions (old-age survivors insurance 4.2 per cent; disability 0.7 per cent; military compensation 0.15 per cent; unemployment insurance 1 per cent). No contribution is levied on income in excess of CHF106,800. Employees with annual wage exceeding CHF19,350 must contribute to company’s pension scheme; contributions vary depending on scheme (the scheme must meet certain standards). Employer has to bear at least one-half of overall contributions of the employee. Capital gains: residents not subject to CGT on gains from movable property or where real estate is held for private investment purposes. Non-residents: subject to CGT on gains from land/building structures in Switzerland and assets used in carrying on a trade/business from a permanent establishment in Switzerland.

Table 10.2: Comparing tax treatment of temporary residents (expatriates) with resident and non resident individuals (continued)

Country	Key temporary residence rules (expatriates)	Liability to tax	Tax rates	Tax base (including social security contributions/obligations of employees and employers)
United Kingdom	Resident, but not ordinarily resident in the United Kingdom (that is, intend to remain for less than three years) or who are domiciled outside the United Kingdom.	Residents: worldwide income. Expatriates: earnings from United Kingdom employment and other foreign source income remitted to the United Kingdom. Non-residents: United Kingdom source income.	Income: no difference between residents and non-residents. Capital gains: no difference between residents and non-residents.	Income: non-residents generally do not get access to the standard deduction. All individuals resident in the United Kingdom for 12 months or more are entitled to free medical treatment under the National Health Service. This is financed out of general taxation (there are no additional specific contributions or taxes). Social security benefits: benefits are divided between contributory benefits and non-contributory benefits. Contributory benefits (unemployment, pensions) are those which are paid to individuals who have the requisite contributions record. The contributions referred to are national insurance contributions (that is, contributions to the National Insurance Fund) out of which contributory benefits are paid. Non-contributory benefits (for example child benefit) do not require a contributions record and are funded out of general taxation. All individuals present in the United Kingdom are liable to pay national insurance contributions, whatever their level of income, once it exceeds a basic threshold. A lower rate of contributions is payable by those employees who are members of a contracted-out occupational or personal pension scheme. Employers are also liable to pay national insurance contributions in respect of their employees. The employers' contributions function as a payroll tax. Expatriates: foreign nationals coming to the United Kingdom do not have to pay national insurance contributions for the first 52 weeks after arrival provided their stay in the United Kingdom is temporary, they are employed by a foreign employer and their normal place of abode before arrival was not the United Kingdom (otherwise liability generally arises immediately upon arrival). Most social security treaties provide that foreign nationals will be exempt from liability to national insurance contributions for a fixed period after arrival, provided they have a certificate from their home country attesting to their continued liability to the equivalent tax there. Capital gains: comprehensive (residents). Comprehensive, but foreign gains only when remitted to the United Kingdom (expatriates). United Kingdom land and business assets (non-residents).
United States	None	Residents: worldwide income. Non-residents: United States source income.	Income: non-residents taxed as per residents but are taxed flat 30 per cent on investment income. Capital gains: no difference between residents and non-residents.	Income: non-residents cannot use married filing or head of household returns. Also, cannot claim dependents exemptions. Residents are able to claim interest deductions on home loans used for a principal residence; non-residents unlikely to have United States principle residence. Residents and non-residents are subject to social security (ie old-age, survivors and disability insurance) and Medicare tax on remuneration paid for services performed within the United States regardless of whether the employee will be eligible for benefits. National law requires employers to withhold social security and Medicare taxes from remuneration. For 2005 the first US$90,000 of remuneration paid to each employee is subject to social security tax at a rate of 12.4 per cent (employer pays 6.2 per cent and withholds 6.2 per cent from the employee's remuneration). The Medicare tax is imposed on the employee's entire remuneration at a rate of 2.9 per cent (employer pays 1.45 per cent and withholds 1.45 per cent from the employee's remuneration). Certain exemptions available to non-resident aliens under social security totalisation agreements, if those non-residents continue to pay social security taxes in home country. Capital gains: comprehensive (residents). Generally exempt, but United States real property gains are taxed at marginal tax rates (non-residents).

(a) Tax Laws Amendment (2006 Measures No. 1) Bill 2006, which includes measures affecting the tax treatment of temporary residents, is currently before the Australian Parliament. If enacted as introduced, these measures will align more closely Australia's tax treatment of temporary residents to that of other countries, in part by generally exempting their foreign non-employment income.
Source: Various, see Chapter 1 (1.4.1).

Table 10.2 shows that temporary residence rules generally limit the tax base to employment income and domestic source investment income. Among the countries that have special taxation rules for these individuals, however, there is a general trend to limit these rules. Limitations can relate to: exempting non-employment foreign income only if it is not remitted to the country; providing that the exemption only applies for a maximum period of time; and providing that the exemption is only available to individuals with scarce specific expertise (that are not generally available in the particular country concerned).[4]

Table 10.2 also shows that most countries apply the same tax rates to residents and non-residents. Where differences in treatment apply, the general trend seems to be for non-residents to be subject to a slightly higher effective tax rate. Australia's approach is consistent with this general trend.

In terms of income, most countries treat residents similarly by taxing worldwide income; they also treat non-residents similarly by taxing domestic source income only. As between residents and non-residents, some countries will often allow residents to claim some deductions and relief not available to non-residents. For countries that have a compulsory medical insurance system, non-residents are usually not covered and therefore not required to contribute.

In terms of capital gains tax, most countries comprehensively tax residents, but limit the taxation of the gains of non-residents to land or real property situated in the country concerned. Australia does not currently have such a limitation.[5]

Countries that levy social security contributions taxes often apply them equally to their residents, temporary residents and non-residents alike. Some countries deny temporary and non-resident individuals entitlement to the related benefits (for example, the United States).

10.3.2 Treatment of a company's foreign source income

As with individuals, resident companies are generally taxed on their worldwide income while non-resident companies are generally only taxed on their domestic source income. Temporary residence tests are not necessary for companies.

Typically, all residents are taxed on their foreign source income unless the income is expressly carved out of the tax base by a foreign income exemption, either unilaterally (in the domestic law) or by a tax treaty with another country. Table 10.2 showed that resident individuals across the OECD-10 are generally comprehensively taxed (with relatively few exemptions) on their worldwide employment, business and investment income. Key reasons for this may be to achieve horizontal and vertical equity goals, and to improve the tax neutrality of investment decisions (efficiency).

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4 The Australian Government announced in the 2005-06 Budget (and has recently introduced legislation to Parliament) measures to align more closely our tax treatment of temporary residents to that of other countries. Once enacted, Australia will have few restrictions in its temporary residence rules. The main limitation will be simply that the individual hold a temporary visa and not be an Australian resident for social security purposes (whether directly or via their spouse).

5 The reforms announced in the 2005-06 Budget to the capital gains tax treatment of non-residents will bring Australia into line with international practice.

By contrast, resident companies typically receive greater exemptions, particularly on their foreign business income. A key reason for this may be because such exemptions interfere less with goals of horizontal and vertical equity, given the withholding aspect of corporate taxation, and the existence of a subsequent taxing point on company income (when the dividends are distributed to resident shareholders).

Foreign income exemptions for resident companies can be based on:

- the type of income earned (for example business, investment income);
- the type of country the income is sourced from (for example comparable tax, treaty or non-tax-haven countries);
- the type of non-resident entity that earns the foreign income on behalf of the resident company (for example company, superannuation fund, managed fund);
- the degree to which it has been taxed (for example subject to tax, taxed at 75 per cent of the resident company tax rate, taxed by a listed country); or
- a combination of the above.

Table 10.3 shows for the OECD-10 the extent to which resident companies are taxed on their foreign source income, and in particular, the foreign income exemptions they receive.

Table 10.3: Treatment of foreign source income of corporate residents

Country	Taxation of resident companies	Key foreign income exemptions from worldwide income taxation
Australia	Corporate residents subject to tax on worldwide income and capital gains. Foreign income exemptions are extensive (based on active income and active business tests), with FTC system unilaterally covering the rest. Non-exempt foreign losses are quarantined from domestic income on a per-class (of income) basis and can be carried forward indefinitely (and set off against future foreign income of the same class).[a] Foreign affiliate: foreign company in respect of which a resident company owns directly at least 10 per cent of the voting stock (a 'non-portfolio' interest). A foreign affiliate effectively also has a (foreign) affiliate if it owns a non-portfolio interest in another foreign company.[b]	Foreign branch business profits (active income) are exempt. Non-portfolio dividends are exempt, including when paid through a chain of foreign companies. Capital gains on shares in foreign affiliates carrying on an active business are exempt. (Full participation exemption.)
Canada	Corporate residents subject to tax on worldwide income and capital gains. Foreign income exemptions are narrow, with FTC system unilaterally covering the rest. All foreign branch income is assessable with unilateral credit, as are most types of foreign dividends and all other foreign income. Foreign losses are deductible against domestic income without recapture against, or recharacterisation of, future foreign income. Foreign affiliate: foreign company in respect of which a resident company owns (directly or indirectly) at least 10 per cent of the shares of any class.	No unilateral exemptions. Generally, only dividends from foreign affiliates in treaty countries paid out of 'exempt surplus' (active or business income and certain capital gains) are exempt.
Ireland	Corporate residents subject to tax on worldwide income and capital gains. Essentially, there are no foreign income exemptions, and FTC system only partially covers the rest (mainly by treaties). All foreign branch income assessable, with foreign tax generally deducted as business expense (unless treaty applies). Foreign losses are quarantined from domestic income on a per-source basis and can be carried forward indefinitely. Foreign affiliate: foreign company in respect of which a resident company owns (directly or indirectly) at least 5 per cent of the ordinary share capital.	None

Table 10.3: Treatment of foreign source income of corporate residents (continued)

Country	Taxation of resident companies	Key foreign income exemptions from worldwide income taxation
Japan	Corporate residents subject to tax on worldwide income and capital gains. Essentially, there are no foreign income exemptions, with FTC system unilaterally applicable. All foreign branch income and qualifying participation dividends and capital gains are assessable with a credit for foreign tax paid. Foreign losses are deductible against domestic income without recapture against, or recharacterisation of, future foreign income. Foreign affiliate: foreign company in respect of which a resident company owns (directly or indirectly) at least 25 per cent of the voting shares (for previous six months).	None
Netherlands	Corporate residents subject to tax on worldwide income and capital gains. Foreign income exemptions are very broad, with a treaty and developing country-based FTC system, and deduction method of double tax relief, covering the rest. Foreign losses are deductible against domestic income without recapture against, or recharacterisation of, future foreign income (unless the foreign branch is subsequently converted into a subsidiary, in which case prior-year losses may be recaptured against future dividends of the subsidiary). Foreign affiliate: foreign company in respect of which a resident company owns (directly or indirectly) at least five per cent of the issued and paid-up share capital and is subject to tax in its country of residence.	All foreign branch income subject to foreign tax or from a treaty country is exempt, as are qualifying participation dividends and capital gains. 'Exemption with progression' exists (as taxable profit below €22,689 is taxed at 25.5 per cent and at 29.6 per cent above it). Excess exempt foreign losses can reduce future foreign income from the same country.
New Zealand	Corporate residents subject to tax on worldwide income but not capital gains (as New Zealand has no capital gains tax). Foreign income exemptions are effectively narrow, with FTC system unilaterally covering the rest. All foreign branch income is assessable with a unilateral credit. Foreign losses are deductible against domestic income without recapture against, or recharacterisation of, future foreign income.	Foreign source dividends received by companies are exempt from income tax, but subject to foreign dividend withholding payment. (Grey-listed country entities, including controlled foreign companies (CFCs), are generally exempt from attribution.)
Spain	Corporate residents subject to tax on worldwide income and capital gains. Foreign income exemptions are quite broad, with FTC system unilaterally covering the rest. Losses of foreign permanent establishments (PEs) are deductible against domestic income but recapture occurs against future exempt or assessable income of that PE (that is, future PE income is made assessable without credit). Foreign affiliate: foreign company with an active business in a comparable country (that is, a tax treaty country with provisions for Exchange of Information) in respect of which a resident company owns (directly or indirectly) at least five per cent of the capital stock, uninterrupted for at least one year.	Income of PEs, and dividends from (including capital gains on sale of interests in) foreign affiliates, in comparable tax countries, undertaking active business, are exempt.
Switzerland	Corporate residents subject to tax on worldwide income and capital gains. Foreign income exemptions are extensive, with FTC system unilaterally covering the rest. Foreign losses are generally exempt – no quarantining. Exempt foreign income and losses used to calculate marginal tax rate of company (exemption with progression), and therefore FTC cap. Foreign affiliate: foreign company in respect of which a resident company owns (directly or indirectly) at least 20 per cent of the capital or the value of the participation is at least CHF2 million. Participation relief for capital gains has the additional requirement that ownership must be for the previous 12 months.	Income attributable to a foreign business or PE and income from foreign immovable property are exempt. Foreign dividends, interest and royalties only qualify for the exemption if derived through, and attributable to, a foreign PE. A partial participation exemption effectively applies in respect of foreign dividend income — 5 per cent of the grossed-up dividend is excluded from the effective exemption.

Table 10.3: Treatment of foreign source income of corporate residents (continued)

Country	Taxation of resident companies	Key foreign income exemptions from worldwide income taxation
United Kingdom	Corporate residents subject to tax on worldwide income and capital gains. Essentially, there are no foreign income exemptions, with FTC system unilaterally applicable. All foreign branch income and qualifying participation dividends and capital gains are assessable with a credit for foreign tax paid. Foreign losses are deductible against domestic income without recapture against, or recharacterisation of, future foreign income. Foreign affiliate: foreign company in respect of which a resident company owns (directly or indirectly) at least 10 per cent of the voting power.	None
United States	Corporate residents subject to tax on worldwide income and capital gains. Essentially, there are no foreign income exemptions, with FTC system unilaterally applicable. All foreign branch income and qualifying participation dividends and capital gains are assessable with a credit for foreign tax paid. Foreign losses are deductible against domestic income, but recaptured by setting off future foreign income of the same class (recharacterising it as domestic income, which prevents FTCs from arising). Foreign affiliate: foreign company in respect of which a resident company owns directly at least 10 per cent in the voting stock (or owns indirectly at least five per cent in each of the lower tier foreign companies).	None

(a) Implementation of 2005-06 Budget announcement will remove all foreign loss quarantining.
(b) Many OECD countries have foreign affiliate rules which allow resident companies more generous tax treatment of the income and gains arising from their foreign affiliates (for example, exemptions or credits for underlying foreign taxes paid).
Source: Various, see Chapter 1 (1.4.1).

Some countries tax the foreign source income of their resident companies comprehensively (for example, the United States, the United Kingdom, Japan and Ireland) while others allow their companies extensive foreign income exemptions (for example, Australia, Switzerland, the Netherlands, and to a lesser extent Spain).

Australia exempts extensively the foreign income of its resident companies. Foreign 'active' income (trading or business income) is generally exempt, as are the capital gains from the sale of active foreign businesses; generally only foreign income that is passive or arises from related party transactions is taxable at the Australian company level. This active income exemption is quite extensive relative to the other OECD-10 countries (and OECD practice in general), as most have more piecemeal or conditional exemptions.

10.3.3 Foreign tax credit (FTC) systems

Where a resident's foreign source income is not exempt, it remains assessable and potentially subject to double tax. In these circumstances, double tax may be relieved by the resident country, either unilaterally or through treaties, by allowing credits for the tax paid in the foreign country (against the resident country's tax), or the foreign tax to be deducted as an expense of doing foreign business. Box 10.4 provides further detail on the features of FTC arrangements.

Box 10.4: Features of FTC systems

Most countries have FTC systems where certain foreign 'income-like' taxes are creditable with credits being limited or 'capped' by the amount of home country tax payable on the foreign income. Other key defining features of FTC systems include:

- whether only certain foreign income is eligible for FTCs for example, non-passive income;
- whether only foreign income from certain countries is eligible for FTCs for example, treaty countries;
- whether the FTC cap is protected by a form of quarantining, either on a per-class of income, per-country or per-source basis (or multiple bases);
- the treatment of foreign losses; and
- whether FTCs in excess of the cap may be carried forward (or back) a number of years, or are wasted.

Table 10.4 shows for the OECD-10 the key features of their FTC systems.

Table 10.4: FTC system comparison

Country	Key features of FTC system	Treatment of excess FTCs
Australia	Credits available unilaterally and through treaties for foreign income-like taxes. Credits capped at Australian tax payable, and quarantined on a per-class (of income) basis — one active and three passive.[a] Dividends from foreign affiliates are exempt (full participation exemption), so no credits or indirect credits for underlying foreign taxes.	Excess FTCs can be carried forward for five years and set off against Australian tax on future foreign income of the same class.
Canada	Credits available unilaterally and through treaties for foreign income-like taxes. Credits capped at Canadian tax payable, and quarantined on a per-class (of income) basis — one business and one non-business class (which includes property and capital gains) — and on a per-country basis. Dividends from foreign affiliates in non-treaty countries paid out of exempt surplus, are taxable as *business* income, with credits and indirect credits for underlying foreign taxes paid, and are quarantined on a per-source basis. Other dividends from foreign affiliates (that is, those paid out of 'taxable surplus', which includes passive income and capital gains), are taxable as *non-business* income, with credits and indirect credits for underlying foreign taxes paid, and are also quarantined on a per-source basis. No tier limit for indirect credits.	Excess FTCs on foreign business income (only) can be carried back three years and carried forward 10 years and set off against Canadian tax on future foreign income of the same class and country. Excess FTCs on foreign non-business income cannot be carried back or forward but may be claimed as a deduction in the year the foreign tax is paid. FTCs on non-business income are used first.
Ireland	Credits available unilaterally (although limited to certain foreign income), through treaties generally, and through certain EU directives, for foreign income-like taxes. Unilateral credit relief limited to foreign dividends (and foreign withholding taxes on the foreign income of certain companies taxed at the special 10 per cent rate, expiring by 2010). Credit relief for all other foreign business income and foreign interest and royalty income only available by treaty. Credits capped at Irish tax payable, and quarantined on a per-item basis generally. Dividends from foreign affiliates are taxable with credit and indirect credits for underlying foreign company (only) taxes paid, and can be pooled with other foreign affiliate dividends. FTCs on non-foreign affiliate dividends are quarantined on a per-item and per-source basis. No tier limit for indirect credits.	Excess FTCs on foreign dividends (only) can be carried forward (indefinitely) and set off against Irish tax on future foreign dividend income. (Under treaties, taxpayer can elect to forgo credit for deduction relief instead.)
Japan	Credits available unilaterally and through treaties for foreign income-like taxes. Credits capped at Japanese tax payable (based on the proportion that taxable foreign income is to overall taxable income), and calculated on a global basis (that is, not quarantined). FTCs are available against national corporation tax, then against prefectural inhabitants tax, then against the municipal inhabitants tax. Dividends from foreign affiliates are taxable with credits and indirect credits for underlying foreign taxes paid, and are not quarantined. Two-tier limit for indirect credits.	Excess FTCs (in addition to excess limitation) can be carried forward for three years and set off against tax on future foreign income.
Netherlands	Credits available only through treaties for foreign income-like taxes. (Credits also allowed for foreign taxes on dividends, interest and royalties from certain developing countries.) Credits capped at the Netherlands tax payable (based on the proportion that the taxable foreign income is to overall taxable income), and quarantined on a per-source and per-country basis. Dividends from foreign affiliates are exempt (full participation exemption), so no credits or indirect credits for underlying foreign taxes.	Excess FTCs can be carried forward indefinitely and set off against the Netherlands tax on future foreign income of the same country.

Table 10.4: FTC system comparison (continued)

Country	Key features of FTC system	Treatment of excess FTCs
New Zealand	Credits available unilaterally and through treaties for foreign income-like taxes. Credits capped at New Zealand tax payable (based on the proportion that taxable foreign income source is to overall taxable income), and quarantined on a per-source and per-country basis. Foreign dividends received by companies are exempt from tax, but subject to foreign dividend withholding payment of 33 per cent of gross dividend. Foreign withholding tax and some underlying foreign taxes can be offset against the foreign dividend withholding payment (indirect credit only where minimum 10 per cent shareholding is satisfied or resident in 'grey list' country). Dividends derived by individuals are assessable with a direct credit only. Three-tier limit for indirect credits.	Excess FTCs are generally wasted (although those arising from a CFC can be carried forward indefinitely or transferred to another company within the same jurisdiction and within a wholly-owned group).
Spain	Credits available unilaterally and through treaties for foreign income-like taxes. Credits capped at Spanish tax payable, and quarantined on a per-country basis generally (although on a per-PE basis for PE income). Dividends from foreign affiliates are exempt. Dividends from foreign companies that are not foreign affiliates but are at least five per cent owned (directly or indirectly) will be entitled to credits and indirect credits for underlying foreign taxes paid, which are quarantined on a per-country basis. Three-tier limit for indirect credits.	Excess FTCs can be carried forward for 10 years and set off against Spanish tax on future foreign income of the same country (or PE).
Switzerland	Credits available only through treaties for foreign income-like taxes (otherwise, exemption or deduction). Credits capped at Swiss tax payable (a third of the overall FTC is allocated to each tier of government) — no quarantining (all assessable foreign income pooled for FTC purposes). Dividends from foreign affiliates are indirectly exempt (as a result of the participation relief ratio). Federal income tax is reduced by the proportion of net foreign profit to total net profit. Treaties allow a tax credit on request for foreign withholding taxes levied on dividends, interest and royalties.	Excess FTCs cannot be carried forward or back at any level of government and are simply wasted.
United Kingdom	Credits available unilaterally and through treaties for foreign income-like taxes (domestic law allows deduction to be claimed in lieu). Credits capped at United Kingdom tax payable, and generally quarantined on a per-source basis. Credits also limited to what the foreign tax would have been if all reasonable steps had been taken to minimise the amount of foreign tax. Dividends from foreign affiliates are taxable with credits and indirect credits for underlying foreign taxes paid, which can be pooled with other foreign affiliate dividends (although dividends from foreign affiliates that are CFCs are quarantined by source). Dividends from other foreign companies are separately pooled for FTC purposes. No tier limit for indirect credits.	Excess FTCs in relation to pooled foreign affiliate dividends can be carried back three years and carried forward indefinitely and set off against United Kingdom tax on future pooled foreign affiliate dividends. This is similarly the case for CFCs, but on a per-source basis.
United States	Credits available unilaterally and through treaties for foreign income-like taxes (domestic law allows deduction to be claimed in lieu). Credits capped at United States tax payable, and quarantined on a per-class (of income) basis — one active and eight passive 'baskets'. For taxable years beginning after 31 Dec 2006, the eight passive income baskets will be reduced to one, leaving two baskets overall. Dividends from foreign affiliates are taxable with credits and indirect credits for underlying foreign taxes paid, quarantined to one of the several passive dividend baskets (depending on the type of foreign affiliate paying the dividend). Six-tier limit for indirect credits (last three must be CFCs).	Excess FTCs can be carried back one year and carried forward 10 years and set off against United States tax on future foreign income of the same class.

(a) Implementation of 2005-06 Budget announcement will remove FTC quarantining by class of income.
Source: Various, see Chapter 1 (1.4.1).

Australia does not appear to differ substantially from the other OECD-10 countries in terms of its FTC system and key attributes. Australia allows significant double tax relief for income from foreign affiliates (generally by exemption) and quarantines foreign losses to a significant degree.[6]

10.4 TREATMENT OF INCOME OF NON-RESIDENTS

Non-residents are generally only taxed on their domestic source income. This usually includes payments of dividends, interest and royalties from residents and income earned through a permanent establishment (PE), partnership or trust in the country.

Table 10.5 shows for the OECD-10 the way in which these different types of income of non-residents are treated for tax purposes.

6 The Australian Government announced in the 2005-06 Budget the removal of foreign loss and FTC quarantining. This will remove the per-class quarantining of foreign losses and allow them to be immediately deductible against domestic income. It will also remove the per-class quarantining of FTCs. These changes will significantly improve the way in which Australia treats the foreign income of its residents.

Table 10.5: Treatment of income of non-resident taxpayers[a]

Country	Withholding tax on dividends paid to non-residents	Withholding tax on interest and royalties paid to non-residents	Withholding tax on other income paid to non-residents
Australia	Franked dividends attract no withholding tax. Withholding tax on unfranked dividends is 30 per cent. This reduces generally to 15 per cent in the case of double tax agreements (United States and United Kingdom resident companies may receive a rate of zero or 5 per cent on unfranked dividends received in some cases). The Conduit Foreign Income regime allows foreign source income to pass through to non-resident shareholders without any withholding tax.	The rate of withholding tax on interest is 10 per cent with a broad range of exemptions (including interest paid to United States and United Kingdom resident financial institutions under the United States and United Kingdom treaties). Royalties are subject to withholding tax at 30 per cent. Under most treaties, the rate is reduced to 10 per cent, however other rates may apply, for example, 5 per cent under the United States and United Kingdom treaties.	Withholding tax applies at rates provided in previous columns to dividends, interest and royalties received through partnerships and trusts. Whilst not legally a 'withholding tax', Australian source income derived by a non-resident through a trust (other than the types above) is subject to tax in the hands of the trustee (at the rate applicable to the beneficiary) with credit provided to the beneficiary for the trustee tax paid. Rental income is not otherwise subject to withholding tax (but is likely to be subject to tax by assessment as a PE). Unless otherwise provided in a tax treaty certain shipping activities of non-residents within Australia are subject to Australian tax on a deemed taxable income of 5 per cent of relevant freight income. Australia also collects withholding tax on amounts paid to non-residents in respect of certain insurance, gambling, entertainment and construction activities. However, the amounts withheld are fully claimable against the non-residents final tax assessment.
Canada	The primary dividend withholding tax rate is 25 per cent, but may be reduced to 5 per cent, 10 per cent or 15 per cent subject to various double tax treaties.	The basic rate for interest and royalty withholding taxes is 25 per cent. However, this may be lower subject to tax treaties. For interest withholding tax, it may be 10 per cent to 15 per cent depending on the treaty. Royalty withholding tax is generally levied at a rate of between zero and 25 per cent depending on the treaty. Interest on government debt and arm's length debt is exempt provided that the taxpayer is not obliged to repay more than 25 per cent of the principal within five years.	If a non-resident performs services in Canada, a 15 per cent withholding tax applies. (A waiver may be obtained but only if certain conditions are satisfied.) The tax withheld may be refunded to the non-resident, pursuant to a tax treaty. Management fees, estate or trust income, immovable property, alimony, films, periodic pension and annuity payments, and lump sum pension, annuity or similar type payments taxed at 25 per cent, reduced under treaties.

Table 10.5: Treatment of income of non-resident taxpayers (continued)

Country	Withholding tax on dividends paid to non-residents	Withholding tax on interest and royalties paid to non-residents	Withholding tax on other income paid to non-residents
Ireland	Withholding tax of 20 per cent in general. Irish legislation provides an exemption from dividend withholding tax if certain conditions are satisfied. To qualify for the exemption the Irish company's parent must: • be entitled to the benefit of the EU Parent/Subsidiary Directive; or • be a company resident in an EU/treaty country and not be under the control of Irish residents; or • be a company ultimately controlled by residents of EU/treaty countries; or • be a company whose principal class of shares is traded on a stock exchange in an EU/treaty country, or be a 75 per cent subsidiary of such a company; or • be a company wholly owned, directly or indirectly, by two or more companies which are listed on a stock exchange in an EU/treaty country. In practice this results in most dividend payments to non-residents being exempt from withholding tax.	The basic rate is 20 per cent. In relation to royalties, withholding tax only applies to patent royalties or royalties on an asset which is a passively held asset owned by the non-resident. Further, the EU interest and royalty directive eliminates royalty withholding tax on royalties to certain related EU countries. Many treaties reduce the withholding to 0, 5, or 10 per cent. In relation to interest, Irish legislation provides an exemption for interest withholding tax on interest paid to a company resident in the EU or a treaty country.	Rental payments for Irish-located property payable to non-residents are subject to 20 per cent withholding tax. A retention tax, at the standard rate of tax, must be deducted at source by deposit takers (for example, banks, building societies, Post Office Savings Bank, etc) from interest paid or credited on deposits of Irish residents. The retention tax does not apply to interest on deposits beneficially owned by non- residents.
Japan	The basic rate is 20 per cent but may be reduced by tax treaties to zero per cent (for example, United Kingdom, United States and French treaties), 5, 10 or 15 per cent depending on the treaty. Qualification for reduced rates generally requires shareholding of at least 25 per cent and in the case of United States and United Kingdom shareholders, satisfaction of limitation of benefit tests. 7 per cent (national) final withholding tax at source on dividends paid by a publicly traded company to a non-resident through 31 March 2008.	The basic rate is 20 per cent for interest and royalties (for certain categories of interest, the basic rate is 15 per cent or zero per cent). Reduced treaty rates: zero, 10 or 15 per cent depending on treaty. 20 per cent withholding tax also applicable to certain technical services performed in Japan subject to the business profits article in the applicable tax treaty.	Unless otherwise provided in a treaty, 20 per cent withholding tax on partnership distributions to non-resident partners (one exemption provided). Rental income paid to non-residents for use of real property or industrial or commercial equipment also subject to 20 per cent withholding tax.

Table 10.5: Treatment of income of non-resident taxpayers (continued)

Country	Withholding tax on dividends paid to non-residents	Withholding tax on interest and royalties paid to non-residents	Withholding tax on other income paid to non-residents
Netherlands	Dividend payments to non-residents are taxed at 25 per cent, exempted or reduced to 15, 5, or 0 per cent under treaties. Dividends payable to qualifying EU residents are tax free.	Withholding tax is not collected on interest or royalty payments to non-residents.	Management service fees received in relation to management of a Dutch resident company are subject to corporate income tax in the Netherlands.
New Zealand	Withholding tax on unfranked dividends is 30 per cent. This reduces generally to 15 per cent in the case of double tax agreements. The foreign investor tax credit regime effectively reduces company tax by an amount equal to the dividend non-resident withholding tax (NRWT) paid by the New Zealand company to the extent that the dividends paid to the non-resident are fully franked and the company has paid a supplementary dividend to the non-resident equal to the amount of the NRWT.	15 per cent interest and royalty withholding tax is applicable subject to treaty conditions. Interest payable to arm's length lenders eligible for approved issuer levy, under which interest is exempt from withholding tax but subject to 2 per cent duty. Under New Zealand domestic law, in some cases the NRWT becomes a minimum tax and the interest and royalties may be subject to tax at full rates unless the liability is protected by a treaty.	Where a non-resident provides services in New Zealand, a 15 per cent non resident contractor withholding tax (NRCWT) will apply. This tax is fully creditable against any final tax liability for the non-resident (30 per cent in cases where relevant paper work has not been completed). Excess amounts are refundable. Exemptions may apply if the non resident contractor applies for an exemption certificate from the New Zealand revenue authority. Although not technically a withholding tax, amounts of New Zealand tax are withheld from premiums paid to non-resident insurers.
Spain	Domestic withholding tax on dividends is 15 per cent. This is generally reduced to 10 or 5 per cent in a number of treaties. Dividends paid to non-residents by special regime holding companies out of qualifying income are not subject to taxation in Spain. Under the Parent-Subsidiary Directive, dividends distributed by a Spanish company to a qualifying EU parent are exempt from Spanish withholding tax. There is also draft law for the increase of the dividend withholding tax rate from 15 to 18 per cent with effect from 1 January 2007.	The domestic withholding tax rate on interest and royalties is 15 and 25 per cent respectively. This is generally reduced under treaties. Interest received by an EU resident is generally exempt from Spanish withholding tax. Royalties received by qualifying EU companies are taxed at the 10 per cent rate. Note that Spain taxes royalties paid to non-residents in consideration for the right to use computer software, with few exceptions.	Domestic law establishes a residual 25 per cent withholding tax rate. This applies to payments for services rendered from jurisdictions without a double tax agreement, rental income insofar as it does not qualify as royalties, and employment income. Capital gains obtained by non-residents are taxed at the 35 per cent rate, though a draft Bill put forth by the Government would reduce this to 18 per cent.
Switzerland	Withholding tax is 35 per cent. Individual non-residents benefiting from a treaty may be entitled to a reduction of up to 20 per cent, resulting in residual withholding tax of 15 per cent. Corporations with a substantial investment (usually 20 or 25 per cent) benefit from a reduction resulting in only 5 or zero per cent withholding tax. This holds in particular for parent companies within the EU due to bilateral agreements between Switzerland and the EU.	No withholding tax on royalties. Withholding tax on interest is limited to interest that is paid by a bank or to interest where the underlying financial instrument is a bond. The applicable rate is 35 per cent. Treaty relief is common (usually 10 per cent residual withholding tax).	There is some wage withholding tax (progressive rates) levied on salary earned in Switzerland and on old age pensions from Swiss pension funds.

Table 10.5: Treatment of income of non-resident taxpayers (continued)

Country	Withholding tax on dividends paid to non-residents	Withholding tax on interest and royalties paid to non-residents	Withholding tax on other income paid to non-residents
United Kingdom	Withholding tax is not applied on dividend payments to non-residents.	The withholding tax rate on interest payments (‘annual interest’) to non-residents is 20 per cent for non-treaty countries and 22 per cent for royalties. The rates are reduced to zero per cent under most treaties, including with the United States and most European countries.	Rental income is subject to 22 per cent withholding tax. Payments made to non-resident entertainers and sportsmen are also subject to 22 per cent withholding tax.
United States	Basic 30 per cent rate may be reduced or eliminated by treaties. United Kingdom, Australia, Mexico and Sweden are examples of treaties which include zero per cent dividend withholding tax. With the other treaties, mostly 5 per cent for corporates with a required percentage ownership, and 15 per cent otherwise.	Basic 30 per cent rate may be reduced or eliminated by tax treaties. Treaties vary greatly in their treatment of interest. A number of treaties exempt interest payments. Royalties generally attract a rate of 0, 5 or 10 per cent.	A branch profits tax which is a dividend equivalent tax applies for branches. Passive income through a partnership treated the same. Not generally covered by treaties, 30 per cent withholding tax on: • gross rent, but can elect to be taxed at the normal United States marginal rates on the net rent; • annuities; • alimonies; • premiums.

(a) The table does not deal with income which is taxed on a net basis such as where it is attributable to a PE.
Source: Various, see Chapter 1 (1.4.1).

The income of non-residents is treated in a variety of ways across the OECD-10, and Australia does not appear to be unique in its framework or treatment. Most of these countries levy all three of the main non-resident withholding taxes (dividends, interest and royalties) through their domestic law. Some OECD-10 countries do not levy one or more of these (for example, United Kingdom and dividend withholding tax), while others have exemptions or significantly reduced rates under treaties, including Australia. The Netherlands levies no interest or royalty withholding taxes and, by virtue of its extensive treaty network, very little dividend withholding tax too.

Australia's dividend withholding tax base is relatively narrow due to a number of significant exemptions (for example, franked dividends and conduit foreign income). It was further narrowed through recent treaties with the United States and United Kingdom. This is also broadly the case for Australia's interest withholding tax base. Where income of non-residents is taxed, Australia's extensive treaty network reduces applicable rates, particularly on dividends and royalties.

10.4.1 Treatment of conduit income

Conduit income typically arises where a non-resident owns an interest in a resident company which pays dividends out of foreign source income. A country can levy tax on conduit income when the resident company earns the foreign income (if the income is not exempt) and when the income is paid by dividend to the non-resident shareholder (for example, dividend withholding tax). Conduit taxation can also arise where the dividend is distributed along a chain of resident companies interposed between the first resident company and the non-resident.

Conduit regimes can help attract multinational operations and regional headquarter activity. A pure conduit regime imposes no domestic tax on foreign income that is eventually paid to non-residents. The more attractive regimes relieve tax at some or all possible conduit taxation points, either unilaterally or through (an extensive network of) treaties. Very few countries (if any) provide full conduit taxation relief in all circumstances.

No Australian tax is levied on dividends paid directly or indirectly (through interposed resident companies) to non-residents out of the foreign income of a resident company. This includes company tax exemptions for any further interposed Australian companies and no dividend withholding tax. When added to the already extensive company tax exemptions for foreign source income derived by resident companies (see Table 10.3), this gives a complete tax exemption for active business profits earned offshore and repatriated through one or more Australian companies to non-residents. Any passive income or gains sourced offshore by an Australian company remains subject to Australian tax but it may be distributed to non-resident shareholders free of any further Australian tax.

Other conduit examples

Similar conduit taxation issues can arise where investment activity is conducted through a domestic funds manager. Broadly, Australia's tax treatment of such arrangements provides a tax exemption for foreign income earned by the Australian funds manager and distributed to non-resident investors.

As an alternative to receiving distributions of foreign profits from interposed Australian companies or fund managers, non-resident investors can access those profits by disposing of their investments. Where that investment is through an Australian funds manager which holds foreign assets almost exclusively, the non-resident investor is now exempt from capital gains tax on the disposal of the investment.[7]

10.5 ATTRIBUTION AND OTHER INTERNATIONAL TAX INTEGRITY RULES

Foreign source income is normally taxed when derived by, or repatriated to, the resident. This enables residents to shift mobile (passive) assets and income to interposed entities in low-tax countries and defer Australian tax. Attribution rules are integrity measures designed to prevent deferral by including passive foreign income in a resident's assessable income as it accrues. As a result, tax does not influence decisions on where to locate assets and income.

Attribution rules often include controlled foreign company (CFC) rules where residents are taxed on their share of certain (usually passive) income of foreign companies they are deemed to have a controlling interest in. Other attribution rules include foreign investment fund (FIF) rules where residents may be taxed on their share of accrued income in foreign portfolio investments.

Through transactions at non-arm's length prices, related parties in different countries can shift income or profits to a lower-tax country (and deductions to a higher-tax country) and avoid tax. Transfer pricing rules are designed to prevent income being shifted in this way by ensuring more economic prices are charged on transactions between related parties.

By shifting debt (and therefore interest expenses and deductions) to higher tax countries, related parties in different countries can also minimise their overall tax. Thin capitalisation rules are designed to prevent uneconomic levels of debt being shifted to a higher-tax country by denying interest deductions above certain limits.

These rules help countries protect domestic and worldwide income tax bases from being lost to low-tax countries, while low-tax countries generally do not need these rules.

Table 10.6 shows for the OECD-10 the attribution and other international tax integrity rules used.

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7 The Government also announced in the 2005-06 Budget that a similar exemption from CGT would be provided where a non-resident investor disposes of its investment in an Australian company, provided the company's principal asset is not Australian land. When implemented, this change will align Australia's law more closely with OECD practice on capital gains through narrowing the range of assets on which a non-resident is subject to Australian CGT to land and business assets used in Australia. These changes will significantly improve the way in which Australia treats the conduit foreign and other income of its non-residents.

Table 10.6: Attribution and other international tax integrity rules

Country	CFC rules	FIF or other attribution rules	Thin capitalisation rules	Transfer pricing rules
Australia	Yes	Yes — FIF and transferor trust rules.	Yes	Yes
Canada	Yes	Yes — Foreign Investment Entities (FIE) rules.	Yes	Yes
Ireland	No	No	No — besides a basic deemed dividend rule in certain cases for interest payments to a non-resident company or subsidiary in a non-EU or non-treaty country for interests of at least 75 per cent.	No specific rules, although tax authorities may adjust transaction prices between related parties if arm's length principle has not been observed.
Japan	Yes	No	Yes	Yes
Netherlands	No — although for companies, a statutory valuation rule exists where the (fair market value) gain or loss in participations in passive non-resident companies of at least 25 per cent (those with passive assets) of at least 90 per cent is included in taxable income.	No — although for individuals, the worldwide average net value of assets held as at 1 January and 31 December of the tax year is deemed to produce a 4 per cent net yield, flat taxed at 30 per cent (resulting in 1.2 per cent tax on the net assets).	Yes	Yes
New Zealand	Yes	Yes — FIF rules.	Yes	Yes
Spain	Yes	No	Yes	No specific rules, although tax authorities may adjust transaction prices between related parties if arm's length principle has not been observed.
Switzerland	No	No	Yes	No specific rules, although tax authorities may adjust transaction prices between related parties if arm's length principle has not been observed.
United Kingdom	Yes	No	No — replaced on 1 April 2004 by extended transfer pricing rules.	Yes
United States	Yes	Yes — Passive Foreign Investment Companies (PFICs) rules. (Note that Foreign Personal Holding Companies (FPHCs) rules repealed from 31 Dec 2004).	Yes	Yes

Source: Various, see Chapter 1 (1.4.1).

This high level comparison indicates that most of the OECD-10 have CFC rules, while around half have some form of FIF rules. Thin capitalisation and transfer pricing rules are quite common across the OECD-10. Australia has all these integrity rules.[8]

8 The Government's response to the RITA included a commitment to review the FIF attribution rules.

10.6 TAX TREATIES

Tax treaties (or double tax agreements) govern the division of taxing rights between the country where the taxpayer is resident and the country where the income is sourced.

As a net importer of capital and technology, Australia has until recently advocated strong source country taxing rights in its treaty negotiations. As a result, the majority of Australia's past tax treaties provide for withholding tax rates that are higher than the norm in treaties between OECD countries.

Australia's tax treaty policy has moved more toward a residence-based treaty model, reflecting the fact that high levels of withholding tax have been seen to disadvantage Australian companies operating offshore and reduce Australia's ability to attract foreign investment. It seeks to provide a competitive framework for cross-border trade and investment while ensuring that the Australian revenue base is sustainable and suitably protected.

The OECD Model Tax Convention on Income and on Capital (OECD Model) and the tax treaty policy of our key investment partner countries are appropriate benchmarks for considering the comparability of Australia's tax treaty policy. In recent years, Australia has taken significant steps toward a more comparable position by:

- reducing withholding tax (WHT) rates in relation to dividends, interest and royalties (these are now at levels broadly comparable in most respects with the position agreed between the United States, the United Kingdom and Japan);
- aligning our treatment of capital gains with the OECD Model (to be implemented in treaties going forward); and
- including and giving effect to non-discrimination rules.

While in some cases, our practice differs from the OECD Model, it is consistent with countries in similar situations. For example:

- a 5 per cent royalty WHT, where the OECD Model has a zero rate, is broadly consistent with, or lower than, other countries that are net importers of intellectual property, such as Spain, New Zealand and Canada; and
- source taxing rights on income from the exploration for, or exploitation of, natural resources, are broadly consistent with recent treaty practice in resource-rich countries such as the Netherlands, Norway, Denmark and the United Kingdom.

Table 10.7 shows for the OECD-10 the network of treaties in place, their type and key attributes. Australia's current treaty policy will promote tax treaties that are competitive by international standards whilst ensuring that Australia's revenue base is suitably protected.

Table 10.7: Tax treaties

Country	Network	Model predominantly relied on	Key departures from model (with respect to PEs, business profits, withholding taxes and alienation of property)
Australia	42	OECD	**PEs/business profits** • Australia maintains strong source country taxing rights for determining what constitutes a PE. **Withholding taxes** • Australia advocates a 5 per cent WHT rate over royalties (the OECD Model rate is zero). On interest and dividend WHT, the Australian position is in some instances less than the OECD Model tax rate.
Canada	86	OECD	**PEs/business profits** • Canada maintains strong taxing rights over the exploration and exploitation of hydrocarbons. **Withholding taxes** • Canadian tax treaties generally contain a 10 per cent WHT rate on royalties.
Ireland	44	OECD	**PEs/business profits** • Ireland maintains strong taxing rights over the exploration and exploitation of hydrocarbons.
Japan	56	OECD	**Capital gains** • Japan reserves the right to tax gains from the alienation of shares or other corporate rights where the interest is part of a substantial participation (that is, greater than 25 per cent) in a Japanese company.
Netherlands	114	OECD	**PEs/business profits** • The Netherlands maintains strong taxing rights over the exploration and exploitation of hydrocarbons.
New Zealand	30	OECD	**PEs/business profits** • New Zealand maintains strong source country taxing rights for determining what constitutes a PE. **Withholding taxes** • New Zealand tax treaties generally contain a 15 per cent WHT rate on dividends and a 10 per cent WHT rate on royalties.
Spain	106	OECD	**PEs/business profits** • Spain maintains strong source country taxing rights for determining what constitutes a PE. **Withholding taxes** • Spanish tax treaties generally contain WHT rates on royalties of between 5 per cent and 10 per cent. **Capital gains** • Spain reserves the right to tax gains from the alienation of certain substantial interests in a company.
Switzerland	86	OECD	No key departures noted.
United Kingdom	114	OECD	**PEs and capital gains** • The United Kingdom, maintains strong taxing rights over the exploration and exploitation of hydrocarbons.
United States	63	OECD	**Withholding taxes** • The United States excludes investments through certain flow-through entities, (i.e. Real Estate Investment Trusts) from the lower treaty dividend WHT rate.

Source: Various, see Chapter 1 (1.4.1).

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Chapter 11

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11. TAXATION AND LABOUR AND CAPITAL FLOWS

SUMMARY

While the taxation regime can be an important factor at the margin in shaping the economic decisions of individuals and companies on where to work and invest, it is only one of a wide range of complex considerations which influence such choices.

Of the top 10 countries/regions which high-skilled persons in Australia depart to, Australia experiences positive net migration of high-skilled persons from all except for Hong Kong (Special Administrative Region (SAR) of China), where the net loss is small. As all these countries/regions have all-in top marginal tax rates lower than Australia's, it would appear that there are many drivers as to why high-skilled people migrate to Australia.

With respect to foreign investment and particularly foreign direct investment (FDI), again a whole range of factors, not just tax, come into play. Australia has a corporate tax rate less than or broadly equal to four out of five of its top FDI contributors, the top three of which have comprehensive foreign tax credit (FTC) systems.

11.1 INTRODUCTION

In an increasingly integrated global economy, with mobile labour and capital, a number of factors influence the economic decisions of individuals and companies on where to work and invest. For companies, these factors may include: macroeconomic stability; resource endowments; workforce skills; quality of infrastructure; effective economic and political institutions; efficient, open and appropriately regulated financial, product and labour markets; openness to new technology; and an entrepreneurial culture. For individuals, these factors could include: potential gross earning opportunities; the cost of living; the availability of education and health services; leisure opportunities; environmental amenity; and lifestyle preferences. A country's tax regime can be an important factor at the margin in influencing the economic decisions of companies and individuals. But tax is only one of a wide range of complex considerations which influence such decisions and should not be singled out as the most important factor affecting these choices.

This chapter broadly looks at the labour and capital flows between Australia and the rest of the world and what impact (if any) the tax system may be having on these outcomes. The chapter concludes with information on Ireland and the emerging major markets of China and India (see Boxes 11.1, 11.2 and 11.3).

11.2 LABOUR FLOWS

There is a concern that Australia's tax system might be encouraging high-skilled persons to leave Australia and discouraging high-skilled persons from coming, or returning, to Australia. This section looks at Australia's high-skilled migration patterns over recent years and whether differences between Australia's and other countries'/regions' all-in top marginal tax rates possibly relate to them. Other measures of differences in tax systems were considered (for instance, the tax wedge discussed in Chapter 4), but generally comprehensive comparable data was not available.

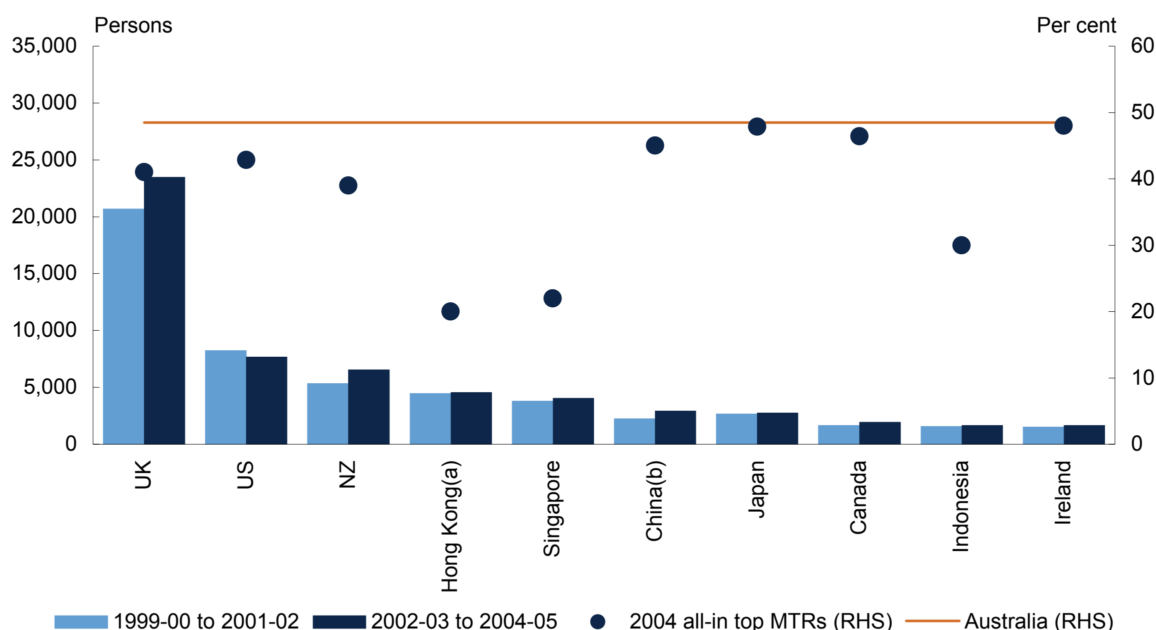
- High-skilled persons are defined as persons stating an occupation that is in the two highest skilled occupational groups in the Australian Standard Classification of Occupations (second edition): Managers and Administrators, and Professionals. Following Birrell et al (2005), persons identifying as self-employed persons are counted as Managers and Administrators.

11.2.1 High-skilled migration

Chart 11.1 shows permanent and long-term departures of high-skilled persons from Australia by country/region of next residence, with average yearly departures in the three-year periods to 2001-02 and 2004-05 compared with all-in top marginal tax rates in destination countries/regions. The countries/regions in the chart are the 10 largest recipients of permanent and long-term departures of high-skilled persons from Australia over the three years to 2004-05. The chart shows a stable pattern of high-skilled departures in recent years, with the United Kingdom dominating other countries/regions as the main destination.

Chart 11.1: Permanent and long-term departures of high-skilled persons from Australia

15 years and over, by country/region of next residence, three-year averages

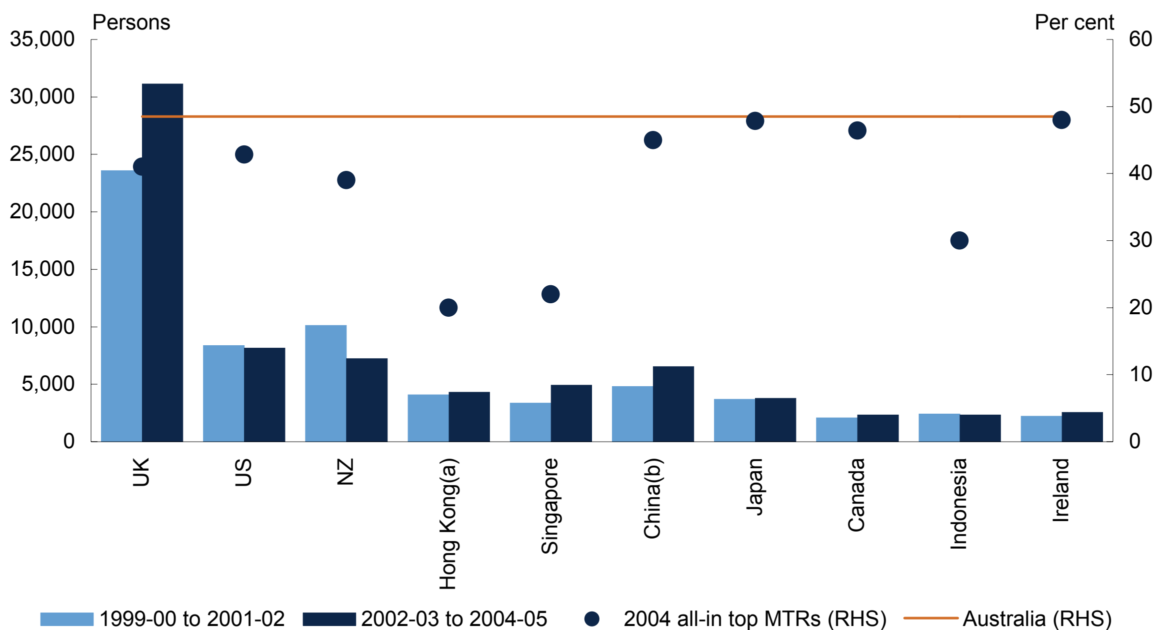


(a) Special Administrative Region (SAR).
(b) Mainland.
Source: Treasury calculations based on Department of Immigration and Multicultural Affairs data.
Note: Total high-skilled persons include both Australian residents and long-term visitors (long-term temporary residents).

Departures of high-skilled persons from Australia should be seen in the context of an Australian high-skilled workforce of over 2.5 million employed persons and substantial arrivals of high-skilled persons from overseas. The large number of arrivals is related to Australia's skilled migration programme and a high return rate for Australian residents departing Australia on a permanent or long-term basis (Birrell et al 2005). Also, high-skilled Australians living overseas, and the presence of high-skilled migrants in Australia, may provide benefits in terms of better access to foreign markets and trade and investment links back to Australia.

As discussed, departures of high-skilled persons from Australia are offset by high-skilled Australian residents returning from overseas and arrivals of high-skilled settlers and long-term temporary residents. Chart 11.2 shows permanent and long-term arrivals of high-skilled persons to Australia by country/region of last residence, with average yearly arrivals over the three-year periods to 2001-02 and 2004-05 compared with all-in top marginal tax rates.

Chart 11.2: Permanent and long-term arrivals of high-skilled persons to Australia
15 years and over, by country/region of last residence, three-year averages

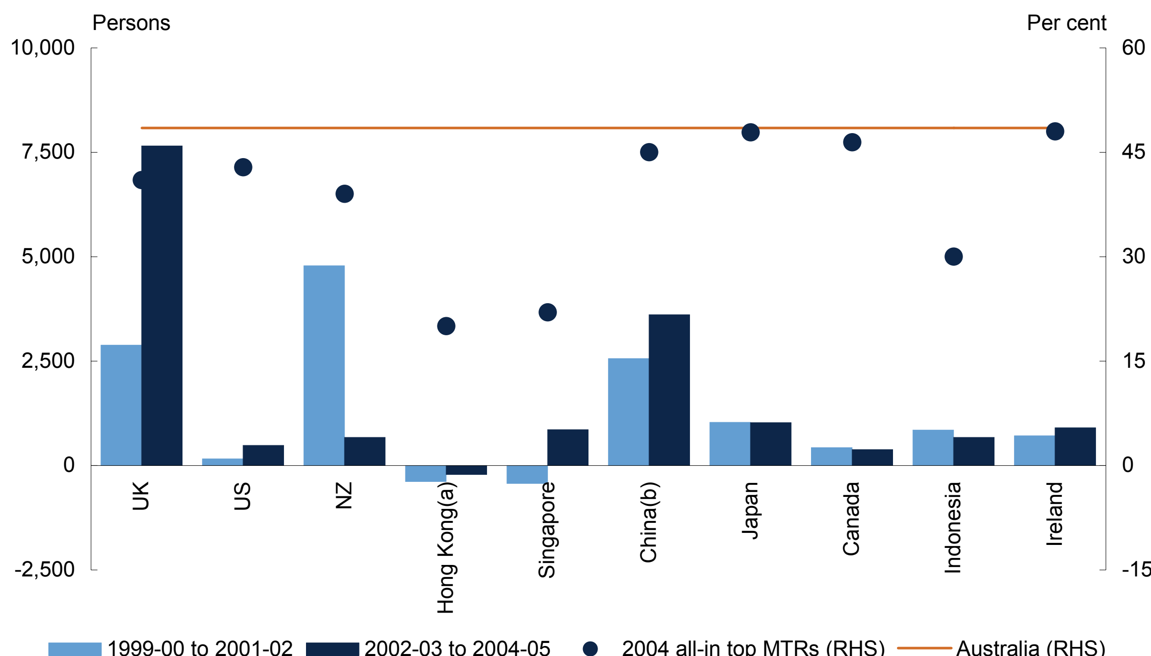


(a) Special Administrative Region (SAR).
(b) Mainland.
Source: Treasury calculations based on Department of Immigration and Multicultural Affairs data.
Note: Total high-skilled persons include settlers, Australian residents, and long-term visitors (long-term temporary residents).

In the aggregate, high-skilled arrivals exceed departures and Australia has a net brain gain from international migration. In the three years to 2004-05, there was an average yearly net contribution to total high-skilled workers in Australia of around 33,000 persons, which has increased significantly since the three years to 2001-02 when the average yearly net contribution was around 24,000 persons. Chart 11.3 shows net permanent and long-term migration of high-skilled persons compared with the all-in top marginal tax rates in the country/region of last or next residence.

Chart 11.3: Net permanent and long-term migration of high-skilled persons into Australia

15 years and over, by country/region of last/next residence, three-year averages



(a) Special Administrative Region (SAR).
(b) Mainland.
Source: Treasury calculations based on Department of Immigration and Multicultural Affairs data.
Note: Net permanent and long-term migration represents the net migration of settlers, Australian residents, and long-term temporary residents.

Of the top 10 countries/regions which high-skilled persons in Australia depart to, Australia experiences positive net migration of high-skilled persons from all except for Hong Kong SAR, where the net loss is small. All these countries/regions have all-in top marginal tax rates lower than Australia's, therefore suggesting there is likely to be a range of factors that individuals consider important, including after-tax wages, adjusted for the cost of living in different countries/regions, cultural ties, the quality of leisure, the availability of education and health services, language differences, environmental amenity, safety, and visa requirements.

A caveat to this analysis is that it assumes workers stating a particular occupation are of equal quality. But quality differences between arrivals and departures of high-skilled persons would have to be significant to detract from the conclusion that Australia is a net gainer of high-skilled labour from international migration.

Another caveat is that the aggregate data mask net losses for particular occupations, although there appear to be net losses for only a small number of high-skilled occupations. Most significantly, in the three years to 2004-05, there were average yearly net losses of around 150 legal professionals and around 360 air transport professionals, including both pilots and air traffic controllers. These net losses are likely to be related to the available opportunities and relatively high incomes that persons in these occupations can earn in other countries/regions.

11.3 Capital flows

This section examines the size and breakdown of investment flows between Australia and the rest of the world, and then considers how Australia's taxation arrangements might influence the investment decisions of multinational corporations.

11.3.1 Australia's international investment position

Australia is a net recipient of capital from the rest of the world, and has been in this position for almost its entire history. Reflecting this, Australia continues to record net income outflows to the rest of the world.

As at 31 December 2004 (latest year for country-by-country breakdowns of Australian FDI):

- Australia recorded a net international investment position of $505 billion, of which $422 billion was net foreign debt and $83 billion was net foreign equity;
- total foreign investment in Australia was $1,155 billion, of which $487 billion was equity investment (of which $298 billion was FDI and $188 billion was portfolio);[1] and
- total Australian investment abroad was $650 billion, of which $404 billion was equity investment (of which $256 billion was FDI and $148 billion was portfolio).

Over 40 per cent of Australia's *inbound* foreign investment stock was equity, of which over 60 per cent was FDI.[2]

By end-2004, the leading investor countries/regions in Australia were the United States (32 per cent of *total foreign* investment stock in Australia), the United Kingdom (24 per cent), Japan (4 per cent), and the Netherlands, Hong Kong SAR, New Zealand and Switzerland (each with around 2 per cent).

- For only FDI into Australia, the order was similar, being the United States (49 per cent of total FDI), the United Kingdom (12 per cent), Japan (5 per cent), the Netherlands (5 per cent) and Switzerland (3 per cent) — see Table 11.1.

By end-2004, the leading countries/regions in which Australia invested were the United States (45 per cent of total Australian investment stock abroad), followed by the United Kingdom (17 per cent), New Zealand (6 per cent), Japan (4 per cent) and the Netherlands (3 per cent).

- For only FDI out of Australia, the order was similar, being the United States (55 per cent of total FDI), the United Kingdom (18 per cent), New Zealand (9 per cent), Cayman Islands (4 per cent) and the Netherlands (2 per cent) —see also Table 11.1.

---

1 For the purposes of this chapter, direct equity investment in Australia is taken to be Australian inbound FDI. (Numbers may not add due to rounding.)

2 Over 60 per cent of Australia's *outbound* foreign investment stock is equity, of which over 60 per cent is FDI. Australia runs similar net investment balances on FDI and portfolio equity (just over $40 billion each).

Australia is attracting significant foreign investment, including FDI and portfolio equity investment. At the aggregate level, it is not clear what impact tax may be having.

11.3.2 Location considerations

Greater economic integration and increased levels of direct investment create opportunities and challenges for businesses operating in the world economy. Some companies with substantial offshore investments have had to decide, for example, whether they can compete successfully while retaining their head office in the home country and how best to access domestic and global capital markets.

Companies now face greater choices in meeting these challenges. Choices exist over the place of residence of the parent company and its subsidiaries, over the location of global and regional head offices and related headquarter functions, and over stock exchange listings. Often the location of these functions may be split between more than one country.

A number of factors can affect the investment decisions (including location and scale) made by domestic and international companies. Tax is only one of a long list of potential factors, such as market proximity, quality of infrastructure, location of other like firms in an industry, presence of related industries, labour force skills and productivity, and political and economic stability. For tax to have an impact on the location decision between countries, the choice between possible locations based on all the other non-tax factors would need to be quite a close one.

11.3.3 Statutory corporate tax rate effect

Community discussions on Australia's tax system and capital flows is often based around the corporate tax rate. This measure is the focus for the discussion below.

Comparing statutory corporate tax rates has its limitations in assessing Australia's corporate tax burden and attractiveness as an investment location. Nevertheless, the corporate tax rate can have headline significance for a multinational corporation trying to decide where to locate a profitable investment project, and for global capital flows in general. (See discussion on effective average and marginal tax rates in Chapter 5.)

Statutory rates can also be important for companies able to engage in profit-shifting through having related foreign parties in lower-tax jurisdictions. Profit-shifting through transfer pricing, thinly capitalising or shifting passive assets and income can reduce the global tax incurred by the group.

- In cases where Australian subsidiaries of foreign parents have significant Australian shareholdings, Australia's imputation system may to some extent encourage profits to be earned and taxed in Australia instead of in a foreign jurisdiction.

Australia's attractiveness as a destination for FDI can be looked at in at least two dimensions. First, whether Australia is attractive as a destination for FDI relative to a foreign company undertaking a similar investment in their *home* country. Secondly, once this threshold has been met, whether Australia is attractive as a destination for FDI relative to a foreign

company undertaking a similar investment in another host (third) country — a country competing for similar FDI.

11.3.4 Impacts of a home country's treatment of foreign income

Tax factors for the marginal investment (assuming non-tax factors are neutral — a strong assumption) include the corporate tax rate differential between the potential host country (Australia) and the home country, as well as the home country's treatment of company foreign income.

Where the host country (Australia's) corporate tax rate is lower, the tax advantage for FDI may be neutralised if the home country has a FTC system.

- Abstracting from attribution rules (discussed in Chapter 10), home country FTC systems typically tax foreign income when repatriated. A tax credit is usually given for foreign tax paid up to the home country tax payable on the foreign income (called the FTC limit or cap). Where foreign tax rates are below the FTC cap, which may be based on the income tax rates applied by national and sub-national governments, home country tax is applied which neutralises the host country's tax advantage.
- A tax advantage for the host country may re-emerge if there is a timing difference between the host and home country taxing points (that is, where repatriation of the foreign income is deferred).

Where the home country provides an exemption for company foreign income (instead of a FTC system), the advantage of the host country having a lower corporate tax rate remains.

- Moreover, with an exemption, home country tax may be deferred even longer, adding further to the host country's advantage.

The potential advantages from a lower corporate tax rate and tax timing differences on inducing FDI is further complicated by the home country's shareholder relief system (for example, imputation, exemption, uniform dividend credit) and the degree to which the resident company in the home country has foreign shareholders (and conduit taxation relief).

11.3.5 Impact of a competitor country's corporate tax rate (and base)

This section considers whether Australia's corporate tax rate is attractive relative to its competitor countries for similar FDI (assuming non-tax factors are equivalent).

For example, resource-rich countries such as Brazil and South Africa may be competing with Australia for the same FDI dollar. Labour-rich countries such as China and India (albeit with tighter foreign capital/ownership controls) may be competing with each other rather than Australia for the labour-intensive manufacturing FDI dollar.

- Brazil has a corporate tax rate of 34 per cent (including the surtax and social contribution tax), which exceeds Australia's. India and China also have higher statutory corporate tax rates than Australia — see Boxes 11.2 and 11.3.

Where competitor countries differ in their tax rates *and bases*, more analysis is required. As discussed in Chapter 5, effective average and marginal tax rate measures are used to assess the value of investments where differences in tax bases also exist.

To be an attractive place for FDI, Australia has to be more attractive to foreign investors than similar investments in the investor's home country. (This aspect is explored further below.) Australia also has to be more attractive than its third country competitors for similar FDI. As discussed in 11.3.2, tax is just one of many possible factors that determine the attractiveness of a location for investment.

11.3.6 Australia's key sources of FDI and their tax systems

Table 11.1 shows the corporate tax rates of those countries which contribute the five highest levels of FDI (direct equity) into Australia.

Table 11.1: Australia's FDI (direct equity) levels, 2004

Country	Share of total FDI in Australia (per cent)	Corporate tax rate(a)
United States	48.6	39.3
United Kingdom	11.9	30.0
Japan	5.3	40.7
Netherlands	5.1	29.6
Switzerland	3.1	21.3
	73.9	

(a) Rates as at 1 January 2006, except for the United States, which is the OECD 2005 full statutory corporate tax rate estimate. These rates include surtaxes and sub-national taxes on corporate income. Surtaxes and sub-national taxes often apply to corporate domestic and foreign income and help determine the FTC cap. The United States, the United Kingdom and Japan use a comprehensive FTC system for taxing the income of offshore subsidiaries and branches.
Source: ABS (2004); OECD Tax Database; and various country websites.

These five countries account for around 74 per cent of Australia's inbound FDI. Australia's 30 per cent corporate tax rate is less than, or broadly equal to, four out of the five countries in Table 11.1. Also, Australia's top three sources of FDI (the United States, the United Kingdom and Japan) all use a comprehensive FTC system for taxing the foreign source income of their companies.

Box 11.1: Have Ireland's low tax rates been responsible for its economic success?

Ireland experienced a rapid transformation in the 1990s, growing, on average, at 9 per cent annually between 1994 and 2000. Ireland's economic success, during this period and subsequently, has been due to its pursuit of sound economic policies (which allowed the country to integrate into Europe and the global economy), the global economic boom in the second half of the 1990s, and generous assistance from the European Union (EU).

Ireland's policy priorities included the removal of barriers to trade and investment, a shift to macroeconomic and fiscal stability, structural reform, encouragement of immigration, and low corporate tax rates. The openness of the Irish economy has enabled it to take a significant share of global FDI flows into the EU. While Ireland has had generally low tax rates, this was just one factor among many contributing to its strong economic performance.

Ireland joined the European Economic Community in 1973, leading to the removal of barriers to trade with Europe during the mid-1970s. This reduced Ireland's economic isolation and created an impetus for the general opening of its economy. Further, structural funding from the EU averaged 1.5 per cent of gross national income (GNI) during the 1980s and 2.6 per cent of GNI in the 1990s (McCarthy 2001).

After running large budget deficits through the mid-1980s, Ireland's fiscal position was stabilised through efforts to reduce expenditure on social initiatives, public capital investment and public sector employment. Between 1988 and 1993, as Ireland prepared to enter into the Exchange Rate Mechanism, exchange controls were progressively relaxed and capital controls dismantled, leading to a fall in interest rates and an increase in demand for credit. From 1993, foreign investors faced lower exchange rate risk in Ireland.

Since 1987, a series of agreements between government, unions and employers have moderated wages growth. These agreements have also lowered personal income tax rates, reducing the wedge between labour costs and personal incomes.

Immigration substantially increased in the 1990s. In 2004, the total Irish population was estimated at just above 4 million, the highest figure since 1871 after being just 2.8 million in 1961. The inward migration flows were an important factor in containing Irish wage costs in the late 1990s when employment growth was strong and the labour market tight. A surge in inward migration of migrants with relatively advanced educational qualifications has also increased the growth potential of the economy.

Ireland's low taxation levels are sometimes identified as a key factor in its economic success. For example, a 10 per cent preferential corporate profit tax (CPT) rate had long been applied to profits from manufacturing and internationally traded services. While it is true that Ireland's tax burden is less than the OECD average, there was no dramatic change in tax rates or in the structure of the tax system during the boom period in the second half of the 1990s. Ireland's low tax rates were just one ingredient in the successful policy mix.

Box 11.1: Have Ireland's low tax rates been responsible for its economic success? (continued)

Recent measures have been aimed at reducing tax distortions. Ireland has wound back preferential CPT and other subsidies in order to harmonise its tax system with EU requirements and make it less distortionary. As a result of negotiations between Ireland and the EU the preferential CPT will be phased out. The *Finance Act 1999* set out the schedule for achieving a single CPT rate as well as reductions in the top rate of personal income tax to 40 per cent (Walsh 2000).

Box 11.2: The emerging major market of China

China has emerged as one of the fastest growing economies in the world over the last 25 years. GDP has expanded at an average rate of 9.6 per cent over that period, resulting in per capita incomes rising by more than 13 times, from US$460 per capita in 1980 to US$5,640 per capita in 2004.[3]

In PPP terms, China was the world's tenth largest economy in 1980, accounting for a little over 3 per cent of world GDP according to IMF estimates. China's significant growth rates have resulted in it becoming the world's second largest economy, and on current trends it is projected to overtake the United States as the world's largest economy by around 2020.

China's emergence has had a significant impact on world demand for mineral and energy commodities, with China accounting for over 60 per cent of world growth in steel production and coal consumption, and over 30 per cent of world growth in oil consumption and electricity generation, between 1998 and 2004.

- The impact of China's rapid industrialisation, driven by China's comparative advantage in low-end manufacturing, has been a key driver of recent movements in global commodity prices.[4]

FDI and trade

China attracted US$60 billion dollars in FDI in 2004, with Australia being the thirteenth largest source of FDI, ahead of other large economies such as France, Canada and Italy.

- Large Australian companies have been making substantial investments in China for many years, in manufacturing as well as property, business and financial services.

Looking forward, continuing opportunities exist for Australian business in China, particularly in the financial services sector.

3 Measured on a Purchasing Power Parity (PPP) basis.
4 China's hourly manufacturing labour costs were estimated to average US$0.57 in 2002 according to a recent study for the US Bureau of Labour Statistics (BLS) (http://www.bls.gov/fls/chinareport.pdf). By comparison, the BLS estimated hourly manufacturing labour costs of US$21.40 for the US and US$15.41 for Australia in the same period.

Box 11.2: The emerging major market of China (continued)

In terms of Chinese outward FDI, Australia was the fourth largest destination for Chinese investment overseas in 2004, ahead of the United States (sixth), Germany (twelfth) and Japan (sixteenth).

- Chinese enterprises have mostly invested in resource and energy developments and minerals processing, reflecting Australia's significance as a key supplier to China's industrial sector.

Trade with China has grown strongly, with Australia's exports to China growing by 31 per cent in 2004-05 to reach $13 billion. China is now our second largest export market and trading partner. Export growth has largely been attributable to strong increases in coal and iron ore trade.

- Australia's total trade (exports plus imports) with China reached $32.8 billion in 2004-05, up from $16.7 billion in 2000-01.

Going forward, China's continuing industrialisation represents a significant opportunity for the Australian economy. Moreover, initiatives such as the 2003 Trade and Economic Framework agreement, China's WTO accession and Australia's involvement in the 2008 Beijing Olympics and 2010 Shanghai Expo, are likely to support continuing development of economic and trade links with China.

- Negotiations have commenced on a Free Trade Agreement with China, which is likely further to enhance trade and investment linkages between the Australian and Chinese economies.

Tax aspects

Australia imposes a lower corporate tax rate on its inbound FDI (30 per cent versus 33 per cent for China on the profits of branches and subsidiaries of foreign multinationals).[5]

- Australia and China are not necessarily competing for the same FDI dollar from key capital exporters like the United States (and in trade, Australia has significant complementarities with China). Australia generally attracts FDI to its resources and high-skills services sectors, whereas China is likely to continue to attract FDI to its manufacturing and construction sectors.

Australia has a higher top personal tax rate (48.5 per cent versus 45 per cent for China).

- While China is sixth in terms of countries that high-skilled persons in Australia depart to (Chart 11.1), Australia is gaining high-skilled persons in net terms from China (Chart 11.3).

It is not clear that tax is (or will be) a significant factor in Australia's ability to attract the capital and skills it needs in the context of the emerging major market of China.

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5 Foreign investment enterprises (FIEs) in China may be taxed at reduced corporate rates (for example, 15 per cent, or even exempt), depending on location and type of business.

Box 11.3: The emerging major market of India

Since embarking on a programme of economic reforms in the early 1980s, which gained momentum in the 1990s, India has emerged as one of the world's fastest growing major economies. Over the last 25 years, India's GDP has expanded at an average annual rate of almost 6 per cent. Over the last three years, growth has averaged above 7 per cent.

As a result, India has grown from being the ninth largest economy in the world in 1980, in PPP terms, to being the fourth largest economy in the world. If current growth rates are sustained, India will overtake Japan in the next few years to become, in PPP terms, the third largest economy in the world (behind only the United States and China).

Despite India's emergence, it remains a relatively closed economy and positive spill-overs from Indian growth have been limited. Nonetheless, as India becomes more integrated with the global economy, it is becoming a greater source of regional and global growth, which is benefiting many countries, including Australia.

Trade and FDI

Over the last five years, India has been one of Australia's fastest growing merchandise export partners, and has now overtaken the United Kingdom to become Australia's sixth largest export market. In 2004-05, exports of goods and services to India amounted to almost $7 billion. This compares to imports of around $1.5 billion, giving Australia a large trade surplus with India.

- Australia's exports to India are dominated by commodities, including gold and coal, and by tertiary education. In contrast, imports are mainly in traditional areas such as gems, floor coverings and jewellery.
- Prospects for trade with India continue to improve as trade liberalisation progresses.
  - The information and communications technology (ICT) services sector, biotechnology, and trade in services including health, education, film, tourism, insurance, energy and power, all continue to show promising potential for growth.
- In March 2006, Australia and India signed a Trade and Economic Framework agreement. The agreement is expected further to boost economic and trade links between the two countries.

Although growing, FDI linkages between India and the world remain relatively low, especially when compared to China. In 2004, India attracted around US$5 billion of FDI inflows and was the source of around US$2 billion in outflows, mainly from and to major trading partners.

The low levels of FDI linkages are partly because India is still in the process of liberalising its foreign investment regime. Other factors such as poor infrastructure and administrative procedures, and labour market inflexibility, are also barriers to investment in India.

Box 11.3: The emerging major market of India (continued)

While FDI flows between Australia and India have been small to date, there are indications that they are on an upward trend.

Going forward, India will continue to have a high potential growth rate for many decades, largely due to its favourable demographics. This is because India is one of the few countries in the world where the population is expected to keep growing over the next 50 years, and more importantly, where the proportion of working-age people will increase well into the 2020s.

Tax aspects

Australia imposes a lower corporate tax rate on its inbound FDI (30 per cent versus 41.82 per cent for India, on the profits of branches and subsidiaries of foreign multinationals).

- Australia and India are not necessarily competing for the same FDI dollar from key capital exporters like the United States.

Australia has a higher top personal tax rate (48.5 per cent versus 30 per cent plus a 10 per cent surcharge for income above Rs 1 million (about A$30,000) plus a 2 per cent education levy on income tax plus surcharge for India).

- India is not one of the top ten countries that high-skilled persons in Australia depart to.

It is not clear that tax is, or will be, a significant factor in Australia's ability to attract the capital and skills it needs in the context of the emerging major market of India.

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Chapter 12

Selected Asian economies

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12. SELECTED ASIAN ECONOMIES

SUMMARY

The approaches to taxation in the Asian economies often differ significantly from the standard practice in the OECD-10. A number of the Asian economies show a strong dependence on company tax (in 2002 Malaysia collected 8.9 per cent of GDP and Vietnam collected 6.9 per cent) well in excess of the OECD-10 unweighted average of 3.4 per cent of GDP.

Whilst Malaysia and Singapore have a mix of direct and indirect taxes which is broadly consistent with OECD practice, a number of the Asian economies (for example, Thailand, Cambodia and Myanmar) rely much more heavily on indirect taxes.

The amount of direct and indirect tax revenue collected as a percentage of GDP for the selected Asian economies does not exceed 18 per cent in 2002. In contrast, in 2003 the OECD-30 unweighted average of tax revenue to GDP was 36.3 per cent. Many of the Asian economies have a significant proportion of their total revenue as non-tax revenue.

The average total outlays for the Asian economies tend to be substantially lower than those of the OECD-10, reflecting the fact that many of the Asian economies are still developing. For instance, Thailand recorded outlays of 19.9 per cent of GDP in 2004, while the unweighted average for the OECD-10 was 38.6 per cent of GDP.

The issues outlined above reduce the value of attempting to compare the Asian economies with OECD countries. In addition, the quality of the data available for the Asian economies is relatively low. In many instances the data which would be required to draw useful comparisons are not available.

12.1 INTRODUCTION

This chapter contains a range of measures of taxation which mirror aspects of the taxation regimes examined across the OECD-10. In broad terms the chapter illustrates some important variations exhibited by the selected Asian economies (Hong Kong, Malaysia, Singapore and Taiwan) in their approaches to taxation relative to the OECD-10. The significance of these variations constrain the usefulness of assessing the importance of differences between the taxation regimes in Asian economies and that of other OECD countries.

A key constraint in examining the selected Asian economies is the availability and quality of data. Available data has been generally sourced from the International Monetary Fund (IMF) Government Finance Statistics publication which utilises different categories and methodologies to that used by the OECD. The data coverage is very mixed, with key items not included in source tables (for instance, source tables did not allow a comparison of the

current total level of government outlays between Asian economies). Where available, data on a wider range of Asian economies have been utilised in producing the charts in this chapter.

The chapter briefly maps out the widely variable approach to the mix of taxation revenue collected amongst the Asian economies. A key finding is that they generally rely on indirect taxes to a far greater extent than OECD countries. There is also a tendency for some of the Asian economies to rely heavily on corporate tax compared to the OECD-10 unweighted average.

Government expenditures as a proportion of GDP are much higher in developed economies, including developed non-OECD economies in the Asian region, than they are in developing economies. Given that citizens in advanced industrial democracies tend to demand greater social expenditure by government, it should be expected that aggregate level comparisons would point to lower government expenditure, and lower taxation, in developing economies when compared with a developed economy such as Australia.

The level of taxation collected by these countries, and their tax burden as a proportion of GDP are generally consistent with the stages of development of many of these economies. Most are relatively poor in comparison to OECD countries, and their relatively low level of tax burden is consistent with this characteristic.

12.2 PUBLIC FINANCE IN ASIAN ECONOMIES

The IMF Government Finance Statistics publication provides an insight into the expenditures of three of the selected Asian economies and highlights some of the problems with data collection in the Asian region. The Government Finance Statistics publication does not provide data for the five other Asian economies examined in Charts 12.1 and 12.2. In addition some of the data raises other issues. For instance, Singapore exhibits particularly high net acquisition of financial assets (which is not otherwise displayed in the 'total outlays' figure) and likewise a high net incurrence of liabilities.

The IMF data indicates that in 2004 Malaysia had a reported total outlay of 30.9 per cent of GDP, Thailand 19.9 per cent of GDP and Singapore 17.2 per cent of GDP. The IMF did not report total outlay data for the other economies canvassed in Charts 12.2 and 12.3.

It is apparent that the Asian economies for which data is available do not generally have the same levels of expenditures as the OECD-10. It is likely that the Asian economies for which reliable data has not been found also have relatively low expenditures.

Ideally a discussion of public finance matters would also consider debt levels and fiscal position. Unfortunately the data required to make meaningful comparisons are just not available for the Asian economies.

12.3 TAX MIX AND TAX BURDEN

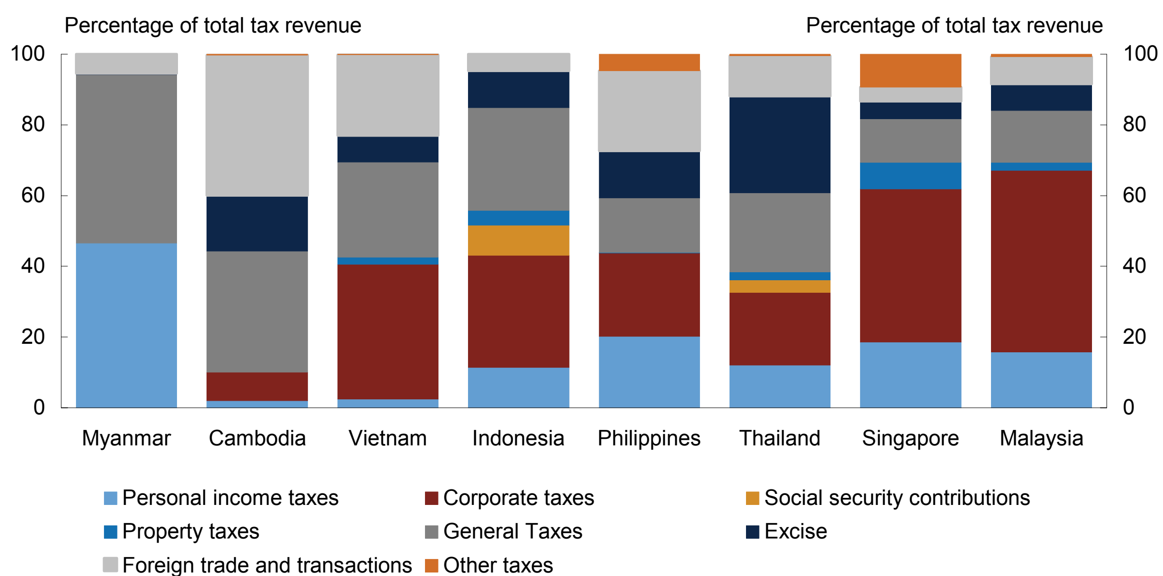
Chapter 3 provides a broad international comparison of the tax mix of OECD countries. It notes that most advanced countries raise the majority of their taxation revenue through the

direct taxation of salaries, wages and profits (the OECD unweighted average was 61.6 per cent of tax raised from direct taxation in 2002 and the weighted average was 64.9 per cent). The remainder is collected through a range of indirect taxes including taxes on property, excises, foreign trade and transactions, and general taxes on goods and services.

In contrast, the Asian economies reviewed in Chart 12.1 vary widely in their approach to raising taxation revenue. Some, such as Malaysia and Singapore, have similarities in approach to the OECD-30 countries. Others, such as Thailand, Myanmar and Cambodia, rely much more heavily on indirect taxation. The significant differences in emphasis in the taxation arrangements adopted in a number of the Asian economies make meaningful international comparisons difficult.

Chart 12.1: Tax mix

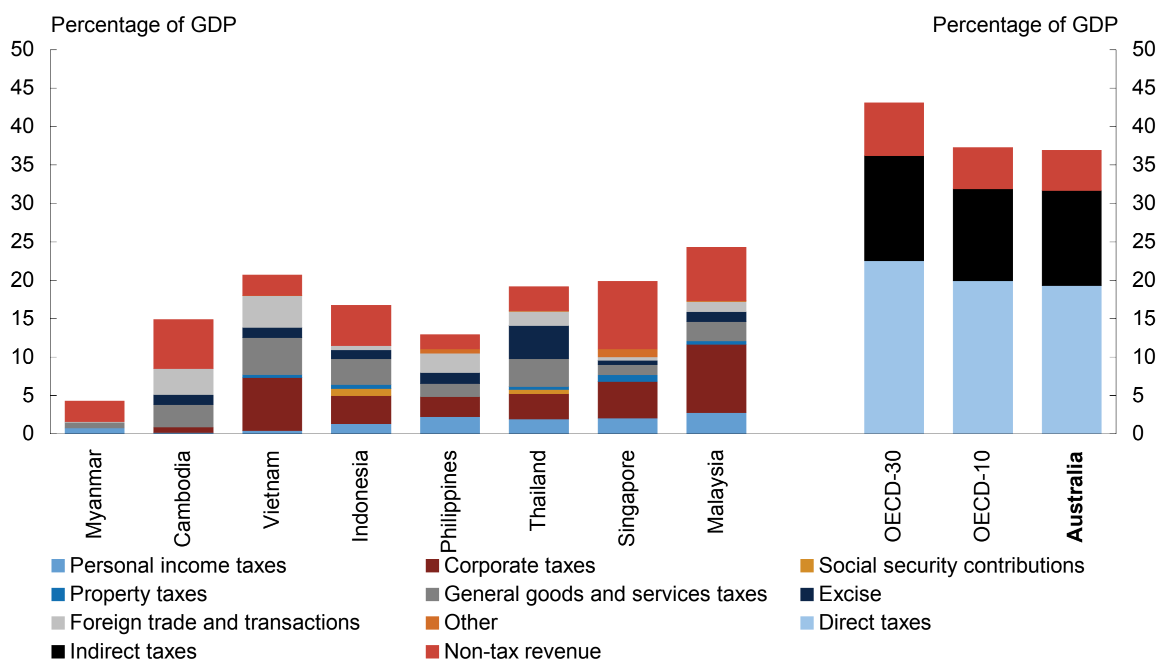
Selected Asian economies, 2002



Source: IMF International Financial Statistics, OECD *Revenue Statistics* 2005.

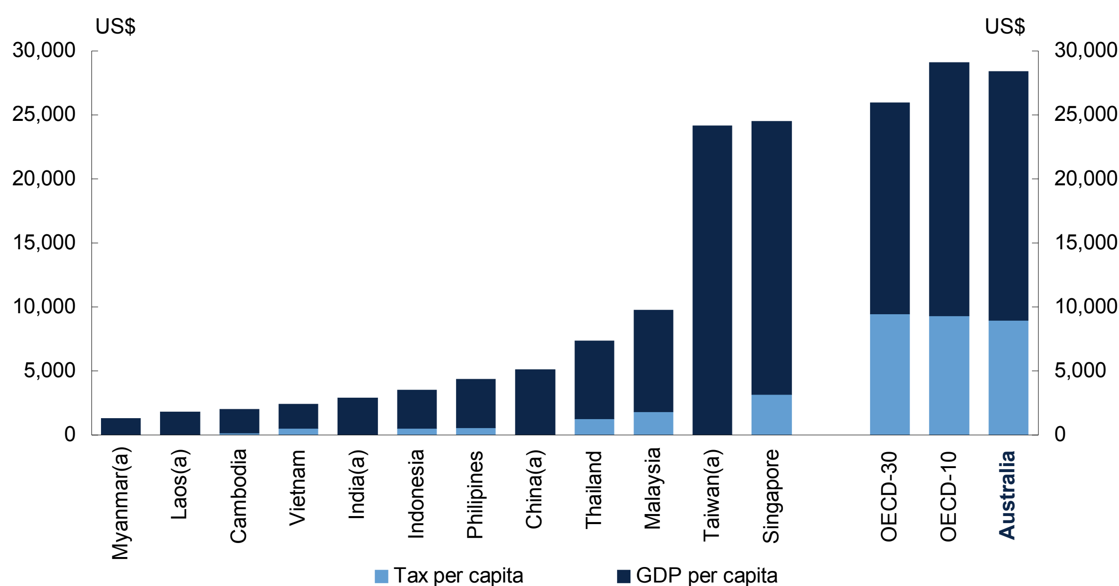
In 2002, the OECD-30 unweighted average of the total tax burden was 36.3 per cent of GDP. In contrast, none of the Asian economies examined in Charts 12.1 and 12.2 collected more than around 18 per cent of their GDP in taxes. This reinforces the comments made in Chapter 2 about the need to consider the counterbalancing issue of expenditure when examining the tax burden faced in a country. A number of the Asian economies in Chart 12.2 also have significant non-tax revenues.

Chart 12.2: Tax and non-tax revenue to GDP
Selected Asian economies, 2002



Source: IMF International Financial Statistics, OECD *Revenue Statistics* 2005.

Chart 12.3: Tax and GDP per capita
Selected Asian economies, 2003



(a) Tax per capita data are not readily available.
Source: IMF International Financial Statistics, OECD *Revenue Statistics* 2005.

Chart 12.3 further illustrates that substantial differences exist between most of the Asian economies and the OECD economies. With the exception of Singapore, Taiwan and Malaysia, the other Asian economies illustrated have GDP per capita which is substantially less than half of the OECD-30 unweighted average. The significant variation across the Asian economies is a clear indication that economic development is at different stages not only in comparison to OECD economies, but also within the Asian region. The tax per capita information further underlines the earlier discussion about the difficulties with obtaining

comparable information as only seven of the 12 countries in Chart 12.3 had data readily available. The smaller expenditures which are characteristic of the Asian economies reinforce the caveat about making comparisons with these economies.

12.4 Company tax burden

Chart 12.2 indicates that there is a wide variation in the company tax burden of the selected Asian economies. Vietnam and Malaysia have very large company tax burdens, particularly when compared to the OECD countries.

The unweighted average for the OECD was 3.4 per cent of GDP and Norway had the highest company tax burden at 8.1 per cent. In comparison Malaysia's 2002 company tax burden was 8.9 per cent of GDP and Vietnam's was 6.9 per cent.

It is difficult to explain why the Asian approaches to company tax vary so widely. In part this is because it is likely that different Asian economies are subject to different influences. In some of the less advanced economies it is possible that the heavier reliance on company taxation reflects administrative issues, such as the ease with which company taxation revenue can be collected compared to some other forms of taxation (for example, personal income tax). But this explanation does not fit comfortably with some other results, and particularly the Malaysian data. Alternatively it is possible that the data could be explained as a result of company income being a much greater component of total income than in the OECD countries.

12.5 Personal taxes

The following six tables deal with various aspects of the personal taxation arrangements which apply in Hong Kong, Malaysia, Singapore and Taiwan. These tables mirror those contained in Appendix 4.4 and Appendix 6.1, which provide detailed information on particular aspects of the personal taxation regimes applying in OECD-10 countries.

Table 12.1 deals with the types of income which are assessable and exempt in each of the selected economies. The arrangements in Hong Kong, Malaysia, Singapore and Taiwan are broadly consistent with the approaches to assessable and exempt income taken by the OECD-10. Taiwan stands out by exempting income from a number of occupations.

Table 12.1: Assessable income — Hong Kong, Malaysia, Singapore and Taiwan

	Assessable income	Exempt income
Hong Kong	Three distinct types of income tax — property tax, salaries tax and profits tax. Individual is liable for salaries tax on income arising in or derived from Hong Kong from any office or employment or profit, and any pension. Profits tax levied on items including royalties, grants, rents from leasing movable property, interest income. Individual may elect for personal assessment in which case salaries tax, profits tax and property tax is aggregated in a single assessment and on a single composite return.	Capital gains. Certain categories of income are exempt from salaries tax including payments from recognised occupational retirement schemes, amounts from scholarships or other educational endowments and amounts received by way of alimony.
Malaysia	Income tax is imposed on income from all sources accrued or derived in Malaysia. Income includes: gains or profits from a business; gains or profits from an employment; dividends, interest or discounts; rent, royalties, premiums, pensions, annuities, or other periodical payments not already included; gains or profits not falling under any of the above. Gains derived from the disposal of real property are subject to real property gains tax.	Several forms of exempt income including: income derived from employment on board a Malaysian ship, scholarship allowances or similar grants to an individual, whether or not in connection with an employment of that individual.
Singapore	Income tax is imposed on employment income sourced in Singapore, rental and leasing income, capital gains, royalties, interest and dividends.	
Taiwan	Income is aggregated for tax purposes. Gross consolidated income is divided into 10 categories. These are: income from profit-seeking operations (including dividends); income from professional practice; salaries and wages; interest income; income from leasing and royalties; income from undertakings in farming, fishing, animal husbandry, forestry and mining; income from transactions in property rights; income from prizes or awards in contests or lotteries; payments for retirement, severance, resignation or pensions which are not paid by insurance; and other income.	Several types of salary are exempt from taxation including payments to military personnel in active service, salaries of teachers and employees of nurseries, kindergartens, public and private schools. Interest received from financial institutions, government bonds, corporate bonds or financial bonds, profits generated from trust funds having the nature of savings received by taxpayers and their spouses and dependants who file income tax returns jointly shall be exempt to the extent of an amount of TW$270,000. Other forms of income such as travel expenses and daily allowances received by an employer are exempt from income taxation up to certain amounts.

Source: Various, see Chapter 1 (1.4.1).

Table 12.2 provides details of the deductions available in the selected Asian economies. All of the countries considered in Table 12.2 offer some form of personal allowances, compared to only half of the OECD-10. Similarly all of the selected Asian economies examined, other than Singapore, offer deductions for social security contributions. In contrast, only three of the OECD-10 allow such deductions. Like most of the OECD-10, all of the selected Asian economies except Taiwan allow tax deductions for work-related expenses.

Table 12.2: Deductions — Hong Kong, Malaysia, Singapore and Taiwan

	Personal allowances	Work related deductions	Taxes/social security	Other deductions
Hong Kong	Personal allowances are granted which reflect the marital status of the taxpayer and the maintenance of various dependants. Basic allowance for a single person of HK$100,000. Married person's allowance of HK$200,000. Child/dependant parent allowance of HK$30,000.	Outgoings and expenses 'wholly, exclusively and necessarily incurred in the production of assessable income' other than expenses of a private domestic or capital nature are to be deducted from assessable income. Specific deductions from income subject to salaries tax for example travelling expenses in the performance of the duties of the office or employment other than travelling expenses from home to the place of work and vice versa. Tax deduction for home loan interest up to certain thresholds.	Contributions to the social security fund — Mandatory Provident Fund Scheme are deductible for employees and self-employed persons.	
Malaysia	Certain standard allowances are deducted to arrive at chargeable income: • Personal allowance: 8,000 ringgit (more if disabled); • Spouse allowance: 3,000 ringgit (more if disabled); and • Child: 1,000 ringgit (more if disabled or a full time student over 18).	Outgoings and expenses incurred in the production of assessable income may be deducted unless disallowed by the Tax Act.	Life insurance premiums and contributions to pension or provident funds: maximum 6,000 ringgit.	Medical expenses: maximum of 5,000 ringgit. Education fees: maximum of 5,000 ringgit. Interest on purchase of residential property: maximum of 2,000 ringgit. Reading materials maximum of 700 ringgit.
Singapore	A general deduction of S$1,000 is available to taxpayers which is increased for seniors over 55 and further for those over 65. A S$2,000 deduction is available where a wife has little income and is fully maintained by a taxpayer. Relief is available for children below 16 or full time students. Of the three payments available, the maximum allowed is S$15,000 for a child under 12 and S$10,000 for a child over 12.	Expenses incurred in the production of income are deductible.		

Table 12.2: Deductions — Hong Kong, Malaysia, Singapore and Taiwan (continued)

	Personal allowances	Work related deductions	Taxes/social security	Other deductions
Taiwan	Personal allowance amount of TW$74,000 (in 2004) for each taxpayer, spouse and his or her dependants (for dependants over the age of 70 the amount is TW$111,000).		Itemised: contributions and donations, insurance premiums, medical expenses, mortgage interest.	Taxpayer can chose between itemising their deductions and taking the standard deduction. Itemised deductions include donations, insurance premiums (including life insurance, labour insurance, government employee insurance and national health insurance), medical expenses, disaster losses, mortgage interest, campaign interest, rental expenses. Standard deduction of TW$44,000 (in 2004). If taxpayer lodges with their spouse standard deduction is TW$67,000. Taxpayer also entitled to special deductions irrespective of whether they choose itemised or standard deduction. Includes special deduction that can be applied against wage income, amount in 2004 was TW$75,000.

Source: Various, see Chapter 1 (1.4.1).

Hong Kong, Malaysia, Singapore and Taiwan all offer opportunities for taxpayers to elect to be either assessed as a family unit or individually. The approaches to the tax unit highlighted in Table 12.3 are not particularly different or unusual when compared with the range of approaches across the OECD-10.

Table 12.3: The tax unit — Hong Kong, Malaysia, Singapore and Taiwan

	Tax unit
Hong Kong	Married couples are assessed individually unless they elect for joint assessment, either for salaries tax only or in the form of a joint personal assessment.
Malaysia	Automatically assessed individually but a joint assessment can be elected.
Singapore	Individual or Hindu joint family.
Taiwan	Generally the taxpayer, spouse and dependants are reported together. However, spouses can have their tax computed separately.

Source: Various, see Chapter 1 (1.4.1).

The approach towards national income tax rates across the selected Asian economies varies. The number of different brackets imposed by Hong Kong and Taiwan is not unusual when compared to the OECD-10. However, both Malaysia and Singapore impose a very large number of brackets. In the OECD-10 only Switzerland imposes a similar number of tax brackets.

Like the OECD-10 the approach to the provision of credits is mixed. Generally, the credits available in OECD-10 countries seem to be broadly consistent with those on offer in Singapore and Taiwan.

Table 12.4: National income tax rates and credits — Hong Kong, Malaysia, Singapore and Taiwan

	Tax rates				Credits
Hong Kong	Rates in 2006-07				
	Up to		HK$30,000	2 per cent	
	Next		HK$30,000	7 per cent	
	Next		HK$30,000	13 per cent	
	Over		HK$90,000	19 per cent	
	However, the maximum tax payable is limited to tax at the standard rate of 16 per cent on the person's income from employment less allowable deductions and charitable deductions, but without a deduction for personal allowances.				
Malaysia	Up to		2,500 ringgit	0 per cent	350 ringgit if income is less than 35,000 ringgit.
	2,501	to	5,000 ringgit	1 per cent	
	5,001	to	20,000 ringgit	3 per cent	
	20,001	to	35,000 ringgit	7 per cent	
	35,001	to	50,000 ringgit	13 per cent	
	50,001	to	70,000 ringgit	19 per cent	
	70,001	to	100,000 ringgit	24 per cent	
	100,001	to	250,000 ringgit	27 per cent	
	Over		250,000 ringgit	28 per cent	
Singapore	Singapore does not operate a pay as you earn system for employment income.				Tax rebates are given to taxpayers with children. A special tax rebate is available for second, third or fourth child whose mother is married or widowed. The amount of the second child rebate depends on the mother's age at the time of birth, it is up to S$20,000. The rebate for third or fourth child is S$20,000.
	Individuals and hindu joint families are taxed as follows:				
	Up to		S$20,000	0	
	S$20,000	to	S$30,00	3.75 per cent	
	S$30,000	to	S$40,000	5.75 per cent	
	S$40,000	to	S$80,000	8.75 per cent	
	S$80,000	to	S$160,000	14.5 per cent	
	S$160,000	to	S$320,000	18 per cent	
	Income over		S$320,000	21 per cent	
Taiwan	2004 taxable year				Personal allowances for each taxpayer, dependant, and spouse are: TW$74,000 (as of 2000).
	Up to		TW$370,000	6 per cent	
	TW$370,001	to	TW$990,000	13 per cent	
	TW$990,001	to	TW$1,980,000	21 per cent	
	TW$1,980,001	to	TW$3,720,00	30 per cent	
	TW$3,720,001	to	and over	40 per cent	
	Bracket amounts are adjusted according to the consumer price index if the index goes up by more than 10 per cent.				
	Income from husbands and wives must be combined for tax purposes, unless the wife has a salary income.				

Source: Various, see Chapter 1 (1.4.1).

Like six of the OECD-10 none of the selected Asian economies impose sub-national income taxes. Given the small physical size of most of them this may reflect a centralisation of the delivery of government services (and therefore a reduced need to raise taxes at a state or local level).

Table 12.5 sets out the social security arrangements applying in the selected Asian economies. Unlike most of the OECD-10, most of the Asian economies examined do not impose some form of social security contributions.

Table 12.5: Social security contributions (SSC) — Hong Kong, Malaysia, Singapore and Taiwan

	Employee SSC	Employer SSC	Self-employed SSC
Hong Kong	No social security contributions levied.		
Malaysia	No social security contributions levied.		
Singapore	Employees that earn over 750 per month make contributions to the Central Provident Fund which is apportioned to three accounts — medisave, old age and the ordinary account. The rate varies depending on age and whether the taxpayer is employed by the government or private sector. Younger people below 35 pay the largest amount — up to 20 per cent of wages — contribution ceiling applies.	Employers contribute to the Central Provident Fund — up to 13 per cent of an employee's wage.	
Taiwan			

Source: Various, see Chapter 1 (1.4.1).

Dividends are exempt from tax in the hands of the recipient in Hong Kong. Malaysia and Taiwan operate an imputation system with Malaysia's being a full imputation system (although not a fully refundable scheme like Australia's). Singapore is in transition from an imputation system to one where dividends will be exempt in the hands of shareholders.

Table 12.6: Integration of company and individual taxation — Hong Kong, Malaysia, Singapore and Taiwan

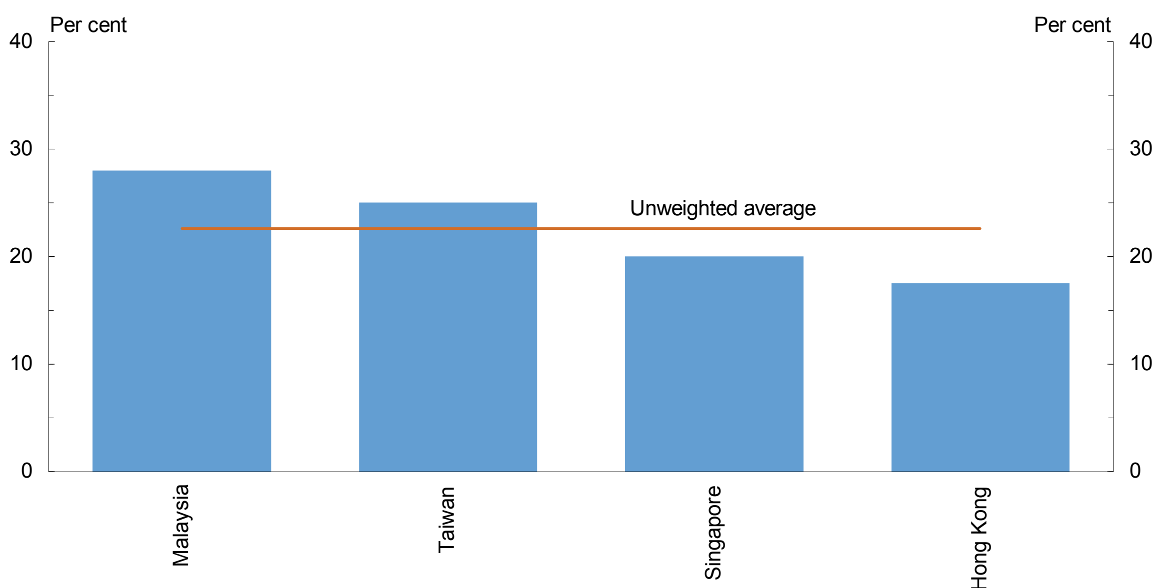
	Treatment of domestic tax paid by company, at company level	Treatment at individual resident shareholder level
Hong Kong (One layer of tax only)	Profits tax is paid at the rate of 17.5 per cent by businesses in Hong Kong who derive profits from Hong Kong.	Dividends are exempt from tax in the hands of the recipient. There is neither a withholding tax nor a credit system. No capital gains on individual level.
Malaysia (Full credit system)	Full imputation applies to dividend distributions. Distributions out of untaxed profit are subject to 28 per cent non-refundable tax.	Dividends to resident individual shareholders taxable with a credit for tax paid at the company level.
Singapore (Credit/one layer of tax)	Credits for taxes paid in Singapore may be attached to dividends distributed. Income sheltered from Singapore tax, because of a foreign tax credit, may be credited to a special account from which tax-exempt distributions can be paid.	From 1 January 2003, a new one tier system of tax was introduced whereby dividends paid-out by a company are exempt from income tax in the hands of shareholders, regardless of whether the dividends are paid-out of taxed income or tax-free gains. There is a five year transition period before the one tier system will fully replace the current imputation system.
Taiwan (Credit)	Imputation credits arise for company tax and credits attach to dividends received.	Gross dividends, including credits, are taxable and imputation credits can be used to offset the recipient's tax liability. Excess imputation credits are refundable to the shareholder.

Source: Various, see Chapter 1 (1.4.1).

12.6 Company taxes

Chart 12.4 provides a snapshot of the statutory corporate tax rates for the selected Asian economies in 2006. The unweighted average corporate tax rate for these economies is 22.6 per cent. In comparison, the unweighted average of the statutory company rate in the OECD-10 in 2006 is 30.8 per cent.

Chart 12.4: Statutory corporate tax rates
Selected Asian economies, 2006



Source: Various, see Chapter 1 (1.4.1).

Table 12.7 illustrates the top combined corporate tax rate faced in Hong Kong, Malaysia, Singapore and Taiwan and includes a brief description of other salient features (such as exemptions or special rates).

Table 12.7: Corporate tax rates — Hong Kong, Malaysia, Singapore and Taiwan

	Top combined corporate tax rate (per cent)	Comment
Hong Kong	17.5	The 17.5 per cent rate covers all profits from carrying on a trade or business (excluding profits from the sale of capital assets) arising in or derived from Hong Kong. No distinction is made between residents and non-residents. There are a number of exemptions or concessional taxation treatments, including for bank deposit interest income and profits from the reinsurance of offshore risks by a professional re-insurer.
Malaysia	28	Companies with paid-up capital of 2.5 million ringgit or less are taxed at 20 per cent on taxable income up to 500,000 ringgit with the normal rate applying to any excess. There are a range of exemptions from the company tax including the income of: resident companies engaged in operating Malaysian ships; income from the rental of international shipping containers received by non-residents from Malaysian shipping companies; and interest received by non-resident companies from deposits with a licensed bank and finance company. For companies carrying on petroleum production the rate is 38 per cent. While insurance companies are taxed at 8 per cent on their investment income the normal rate applies to their shareholders' fund income. Leasing income derived by a non-resident with no permanent establishment in Malaysia for use of movable property is taxed at 10 per cent.
Singapore	20	A partial tax exemption scheme exists for companies, which exempts from tax 75 per cent of up to the first S$10,000 of a company's income; and 50 per cent of up to the next S$90,000 of the company's income. For new companies, a complete income tax exemption (except for Singapore franked dividends) is available for a qualifying company on income up to S$100,000, for any of its first three consecutive assessment years that lie between 2005 and 2009. A concessional tax rate of 10 per cent or less is levied on a range of particular activities including: the financial sector incentive scheme; offshore leasing; offshore insurance and reinsurance; offshore global trading; and finance and treasury operations. Companies engaged in the shipping of outbound passengers, mail, livestock or goods from Singapore are exempt from income tax.
Taiwan	25	The profit-seeking enterprise tax is levied on the income of all business forms including sole traders and partnerships. Rates for domestic enterprises (TW$) Up to 50,000 0 50,000 to 100,000 15 Over 100,000 25 The 15 per cent rate applies to total taxable income but the tax may not be in excess of 50 per cent of the balance of taxable income greater than TW$50,000. If taxable income is greater than TW$100,000, 25 per cent is imposed on any excess. A withholding tax applies to income paid to domestic enterprises (apart from profit distributions) which is generally creditable against the enterprise's tax liability. A foreign enterprise which either has a fixed place of business or has a business agent in Taiwan is taxed as a domestic firm. Other foreign firms are subject only to a final withholding tax which is levied at 15, 20 or 25 per cent depending on the type of income. There are a number of exemptions including: income received by branches of international financial banks; inter-corporate dividends of domestic corporations; the new or expanded income of newly-incorporated or growing enterprises that invest in manufacturing and its accompanying technical services industry with the exemption applying for five years from the time such enterprises sell their new or expanded output; and the income of logistics distribution centres set up in Taiwan by foreign enterprises or their branches only for storage, simple processing and delivery to domestic clients.

Source: Various, see Chapter 1 (1.4.1).

Table 12.8 examines the treatment of losses in the same way as the table in Appendix 5E does for the OECD-10.

Hong Kong, Malaysia and Taiwan, do not permit loss carry back while Singapore has recently introduced loss carry back but with a cap on the amount of losses able to be carried back.

Singapore is the only selected Asian economy that allows the transfer of losses within corporate groups (the majority of the OECD-10 allow loss transfer within groups).

Singapore imposes a continuity of ownership style test on its loss recoupment while the other selected Asian economies either impose no restrictions or non-stringent restrictions on their loss recoupment rules.

Table 12.8: Treatment of losses — Hong Kong, Malaysia, Singapore and Taiwan

	Treatment of tax losses	Transfer (including conditions)
Hong Kong	Unused tax losses carried forward without time limit to offset future profits regardless of whether these profits are from the business or whether the same business is still carried on. No carry back provisions.	No continuity of ownership requirement but specific loss trafficking provisions. No consolidation of tax losses across a group. However, group relief provisions are under consideration.
Malaysia	Carry forward indefinitely (business losses offset against business income, tax depreciation against income from same source only). No loss carry back.	Continuity of share ownership test is required for utilisation of business loss and unutilised capital allowances / tax depreciation. There is no general group relief.
Singapore	Trading losses may offset all other chargeable income of the same year. Any excess unutilised losses, if not carried back or transferred out under group relief, may be carried forward indefinitely for offset against future income from all sources. Similarly any excess capital allowances are allowed to offset against other chargeable income of the same year. Any unrelieved capital allowances, if not carried back or transferred out under group relief, may be carried forward indefinitely for offset against future income derived from the same trade. One year carry-back allowed with effect from Year of Assessment 2006 but limited to S$100,000 of unutilised capital allowances and trade losses.	The loss carry-back and carry-forward provisions are subject to the taxpayer meeting the substantial (50 per cent or more) share ownership test at the ultimate holding company level. For carry-back and carry-forward of unutilised capital allowances, there is an additional provision that the taxpayer must continue to carry on the same business in respect of which the capital allowances arose (same business test). Group relief is available for a Singapore group. A Singapore group consists of a Singapore-incorporated parent company and all of its Singapore-incorporated subsidiaries. Two Singapore-incorporated companies are members of the same group if one is 75 per cent owned by the other, or both are 75 per cent owned by a third Singapore-incorporated company.
Taiwan	For companies which maintain a complete set of accounts and which use 'blue returns', losses may be carried forward for five years. No carry back of losses is allowed.	No

Source: Various, see Chapter 1 (1.4.1).

Tables 12.9 and 12.10 deal with depreciation arrangements and rates and mirrors the OECD-10 information presented in Appendix 5D. Generally, the treatment provided for in the Asian economies discussed in the table below is similar to the OECD-10 approaches to depreciation. The available loadings are somewhat different, in that Hong Kong, Malaysia and Singapore provide loadings for buildings. None of the OECD-10 offer such loadings.

Table 12.9: Depreciation arrangements – Hong Kong, Malaysia, Singapore and Taiwan

	Prime cost (straight line) or declining balance method	Determination of rate	Switching	Loadings	Balancing charge offset	Industry specific arrangements
Hong Kong	Generally can choose either prime cost or declining balance method.	Rate to be chosen that most closely reflects the use and consumption of the asset over its useful life.	Yes	Initial loadings allowed for industrial buildings, plant and machinery and motor vehicles.	Recapture rules and specific rules for asset pools but no offset rules.	Prescribed plant and equipment can be immediately 100 per cent written off.
Malaysia	Prime cost only.	Taxpayers cannot select their own rates or lives. The revenue authority publishes standard rates and the taxpayers must adopt these rates.	No	Once-off initial allowance of 20 per cent for plant and 10 per cent for industrial buildings in the first year, in addition to the standard rate.	Recapture of depreciation on disposal proceeds exceed depreciated value. Additional allowance if proceeds are less than depreciated value.	Specific regimes for agriculture and forestry.
Singapore	Generally can choose either prime cost or declining balance method. Taxpayer can elect for either method on an asset by asset basis at beginning of claim.	(1) Accelerated: three years (one year for certain assets) on a straight-line basis. (2) Straight-line allowance Initial allowance of 20 per cent of the asset's cost followed by a straight-line annual allowance write off of the balance of the qualifying expenditure over the number of years of working life. There are standard depreciation rates laid down in the tax legislation. It is compulsory for the taxpayer to use the rates specified in the tax legislation, as applied to the specific asset.	No switching between methods is allowed. Deferment of depreciation claim is possible. (1) Straight-line allowance Annual straight-line allowances is given on a 'due claim' basis. However the 20 per cent initial allowance must be claimed in first year of claim; after the first year, the entire 100 per cent cost will be written off on a straight-line basis over the remaining number of years of working life. Deferment of annual allowance on a year to year basis is possible. (2) Accelerated depreciation Commencement of claim for accelerated depreciation can be deferred. However once claim starts, it cannot be deferred again.	Yes, accelerated depreciation and investment allowances in the straight-line basis in the year of acquisition. There is an incentive which grants investment allowances. Investment allowances are given in addition to capital allowances and may allow for additional deduction of usually 30 per cent to 50 per cent of the cost of acquisition of the asset.	Recapture of allowances (Balancing Charge) if proceeds exceed the declining balance method and additional allowances (Balancing Allowances) if proceeds are less than tax declining balance method. There are provisions in the tax legislation for deferment of tax impact of a balancing charge where: (1) there is replacement of the specific equipment disposed; or (2) the disposal is made to a related party and the transaction satisfies certain conditions.	No industry specific arrangements. However a special concession is available for assets with value less than S$1,000. To reduce compliance costs, the concession provides for assets costing less than S$1,000 (regardless of the nature of the assets) to be written off over one year. This is provided that the aggregate claim for the one year write off of all such assets is capped at no more than S$30,000 per tax year. For certain industries, as an incentive and to encourage capital expenditure, investment allowances may be given in addition to capital allowances (see earlier reference to investment allowances).

Source: Various, see Chapter 1 (1.4.1).

Table 12.9: Depreciation arrangements — Hong Kong, Malaysia, Singapore and Taiwan (continued)

	Prime cost(straight line) or declining balance method	Determination of rate	Switching	Loadings	Balancing charge offset	Industry specific arrangements
Taiwan	Generally can choose between straight line, diminishing balance or working-hour methods. Depletion of assets in the form of non-replaceable resources is computed either annually or per unit. Taxpayer to apply to authorities to use a method, if no application is made then straight-line method is deemed to be in use.	Time periods over which an asset may be depreciated are specified by tax authorities. There is an official Fixed Assets Depreciation Table available. The taxpayers are allowed to select their own rates or lives to depreciate an asset if pre-approval is obtained from the tax authority.	Allowed to switch the depreciation method during the ownership of an asset if the taxpayer obtains pre-approval from the tax authority. Method for non-replaceable resources must be applied consistently.	The write-off rate may be higher if the taxpayer obtains pre-approval from the tax authority. Companies may use accelerated depreciation if they meet certain criteria.	No	Per Article 5 of the Statute for Upgrading Industries, service life of instruments and equipment purchased by a company for exclusive use for Research & Development purposes, experiments, and/or quality control, or machinery and equipment purchased by a company and used for energy saving purposes or employing new and clean energy may be accelerated to two years. The small business may apply to use the accelerated depreciation method in accordance with the Regulation Governing the Development of the Small Business. Accelerated depreciation for certain industries, equipment used for quality inspection, energy conservation.

Source: Various, see Chapter 1 (1.4.1).

Table 12.10: Summary of annual depreciation rates (selected assets) — Hong Kong, Malaysia, Singapore and Taiwan

	Equipment (approximately 8 year life)	Buildings	Computers	Intangibles
Hong Kong	Initial allowance of 60 per cent for non-manufacturing plant and machinery and office equipment when purchased. Annual allowance of 10 per cent, 20 per cent or 30 per cent is allowable under declining balance method. 100 per cent of manufacturing plant and machinery can be written off when expended.	Industrial buildings — initial allowance of 20 per cent granted on new industrial buildings in year expenditure incurred. Annual allowance of 4 per cent when building first used. No initial allowance for existing buildings. Commercial buildings — annual 4 per cent allowance.	100 per cent can be written off immediately the expense is incurred.	Not allowable.
Malaysia	20 per cent prime cost initial allowance, then 8 per cent to 40 per cent afterwards. Average 10 per cent to 20 per cent.	10 per cent initial allowance, then 3 per cent only for industrial buildings.	Some immediate otherwise 20 per cent initial allowance; then an annual allowance of 40 per cent.	Non-deductible.
Singapore	Straight line allowance: 20 per cent initial allowance, balance over useful life. Equipment depending on the type may have a specified working life of 5 to 16 years. Accelerated allowance: generally three years (although if automated equipment or computers — can be claimed over one year).	25 per cent initial allowance, 3 per cent for subsequent years based on costs for qualifying areas.	Accelerated allowance of one year.	No tax depreciation available nor is goodwill tax deductible.
Taiwan	11.11 per cent (based on useful life plus one year). The useful life of equipment is ranging from 3 to 20 years depending on the type of such equipment.	1.96 per cent = 1/(50+1) 6.25 per cent = 1/(15+1) based on purchase price. Rates based on expected life plus one year.	25 per cent (based on useful life plus one year).	Goodwill cannot be amortised longer than 20 years.

Source: Various, see Chapter 1 (1.4.1).

Table 12.11 sets out the corporate tax concessions available in the selected Asian economies. This information is similar to the information provided for the OECD-10 in Appendix 5F. The Asian economies examined tend to offer a wider range of tax concessions than the OECD-10.

Table 12.11: Corporate tax concessions — Hong Kong, Malaysia, Singapore and Taiwan

	Research & Development	Other concession
Hong Kong	Expenditure deductible at the rate of 100 per cent of the expense.	Interest income derived from certain financial instruments is exempt from taxation. Interest income and trading profits derived by corporations from a qualifying debt instrument of between 3 to 7 years is subject to a tax rate of 8.75 per cent, while those derived from instruments with a longer maturity period are exempt. Exemption for offshore funds, partial exemption of offshore manufacturing income.
Malaysia	Range of preferences including 200 per cent deduction for expenditure in certain cases. Contract Research & Development companies may be entitled to tax exemption on 100 per cent of taxable income for five years or investment tax allowance within 10 years from approval date. Many other tax incentives are also available.	Regional Distribution Centre (RDC) Incentive applicable to collection and consolidation, and distribution activities provides 0 per cent tax on statutory income for up to ten years. Incremental usage of ports and airports. International Procurement Centre (IPC) Incentive if activities consist of procurement and sale only. IPC Incentive may be applied for instead. Criteria and tax benefits are similar to RDC. Reinvestment allowance for qualifying projects of 60 per cent. Infrastructure allowance for related expenses for entities in promoted areas of 100 per cent. Other tax incentives available.
Singapore	Expenditure incurred on Research & Development undertaken directly by a person carrying on a trade/business (except on fixed assets) and related to that trade/business, or payments made by him to a Research & Development organisation, are tax-deductible. Further deductions may be granted on approved Research & Development projects, subject to certain conditions. Note however, expenditure of a capital nature incurred on plant, machinery, land or buildings or on alterations, additions or extensions to buildings or in the acquisition of rights in or arising out of research and development incurred by the taxpayer are not deductible. Further, there are provisions under current tax law for written-down allowances (WDA) where a person carrying on a trade or business has incurred expenditure under any approved cost-sharing agreement in respect of Research & Development activities for the purpose of that trade or business. The WDA available currently is 20 per cent per annum; although in the recent 2006 Singapore Budget, there is a proposal for a 100 per cent WDA claim in the year the expenditure was incurred.	Global Trader Program (GTP) incentive applicable to international companies who manage their regional or global trading activities using Singapore as their base. The GTP Incentive provides for a concessionary tax rate of 10 per cent on qualifying trade income for five years (and renewable). The rate can be reduced to 5 per cent if revenues are significantly higher plus other commitments are met. A modified GTP scheme provides for a 10 per cent concessionary tax rate for three years [but non-renewable] with lower level of commitments. International Headquarters (IHQ) Incentive applicable to MNCs who use Singapore as a base to provide corporate support and headquarters related services and business expertise on a regional or global basis. A concessionary tax rate of between 0 per cent to 15 per cent on incremental qualifying income for a specified period may be awarded. Exact terms of the Incentive grant is determined and negotiated on a case-by-case basis commensurate with the scale, value and sophistication of investment commitment the headquarters puts into Singapore. Factors specifically looked at include factors such as headcount, business spending and quality of people hired. Qualifying income includes trading profits earned by a regional supply chain principal company and management/service fees earned from non-Singapore customers.
Taiwan	Expenditures deductible or amortisable under certain conditions. Accelerated depreciation for equipment used for Research & Development. 15 per cent to 20 per cent investment tax credit (ITC) for investment in Research & Development.	Accelerated depreciation for certain industries, equipment used for quality inspection, energy conservation. Between 5 per cent and 20 per cent ITC for investments in automated production equipment or technology, environmental protection and energy-saving equipment and technology, personnel training, international brand name establishment. Up to 10 per cent or 15 per cent ITC for investment in certain industries in low development areas, payment for certain shares from the effective date on 1 January 2006. ITC or 5-year tax holiday for qualified scientific/technology and investment companies.

Source: Various, see Chapter 1 (1.4.1).

Table 12.12 examines corporate capital gains tax arrangements in the selected Asian economies. Their approach is different to that of the OECD-10, chiefly because of the limited scope of capital gains taxes in these economies. Some gains can be taxed as normal income, others (as in Hong Kong) not taxed at all.

Malaysia uses a stepped rate system for taxing the real property gains of companies while Taiwan uses its progressive corporate tax scale for taxing corporate capital gains.

Table 12.12: Corporate capital gains taxation — Hong Kong, Malaysia, Singapore and Taiwan

	Base	Rate (per cent) — scales are in local currency	Losses	Rollovers
Hong Kong	n/a	n/a	n/a	n/a
Malaysia	All capital gains are exempt except for real estate property or shares in real property companies. Residents and non-residents are subject to real property gains tax on the sale of real property and of shares in a real property company. Real property is defined as land located in Malaysia and any interest, option or right applying to such land. There are a number of exemptions including: (1) for assets transferred between members of a company group where the transfer is designed to improve efficiency and the consideration is only in the form of shares or is substantially in that form with the balance in cash greater efficiency; (2) for the transfer of assets in any corporate reorganisation, restructure or merger; and (3) for distribution of assets by a company's liquidator being part of a corporate reorganisation, restructure or merger. For (2) and (3), scheme must be in connection with transfer or distribution of assets to a company resident in Malaysia which is being restructured in compliance with government policy on capital participation in industry.	The rate scale for companies is shown below. Time of sale from purchase date (years) — Rate (per cent) 2 — 30 3 — 20 4 — 15 5 or more — 5 Insurance companies pay 8 per cent on the capital gains of the life fund.	No loss is permitted to stem from the sale of shares in a real property company. For losses from the sale of real property, the loss (calculated as applicable rate times loss on sale) is allowed as a deduction against total tax on chargeable gains in the year the loss arises. Any excess losses may be carried forward indefinitely.	Rollovers include: (1) for transfer of assets held by an individual to a company controlled by the individual (for a consideration consisting of shares in the company or for a consideration consisting substantially of shares in the company and the balance of a money payment); (2) compulsory acquisitions; and (3) disposal of an asset by a person pursuant to a scheme of financing approved by the Securities Commission or Central Bank which is in accordance with the principles of Syariah.

Source: Various, see Chapter 1 (1.4.1).

Table 12.12: Corporate capital gains taxation — Hong Kong, Malaysia, Singapore and Taiwan (continued)

	Base	Rate (per cent) - scales are in local currency	Losses	Rollovers
Singapore	Singapore currently does not impose tax on capital gains. However, there are no specific laws or regulations which deal with the characterization of capital gains. Hence, gains arising from transactions involving acquisition and disposal of real estate, stocks or shares, may be construed to be of an income nature and subject to corporate income tax if they are seen to arise from activities which are regarded to be the carrying on of a trade in Singapore.	If gains are treated as arising from the carrying on of a trade in Singapore, it could be liable to corporate income tax. The normal corporate tax rate is currently 20 per cent.	Capital losses are not tax deductible. For losses deemed to arise in connection with the carrying on of a trade in Singapore, it should be deductible.	n/a
Taiwan	All gains derived from the sale of property and property rights are taxable as normal income. Capital gains have a Taiwanese source if they stem from transactions located in Taiwan. Domestic profit-seeking firms are taxed on their worldwide capital gains. Foreign profit-seeking firms are taxed only on Taiwan-sourced capital gains regardless of their residence. The gains which are exempt from tax include: gains from the sale of land; gains from the transfer of shares or bonds irrespective of whether they are listed or unlisted; and gains from futures transactions.	Rates for domestic enterprises (TW$). Up to 50,000 — 0 50,000 to 100,000 — 15 Over 100,000 — 25 The 15 per cent rate applies to total taxable income but the tax may not be in excess of 50 per cent of the balance of taxable income greater than TW$50,000. A withholding tax applies to income paid to domestic firms (apart from profit distributions) which is generally creditable against the firm's tax liability. A foreign firm which either has a fixed palace of business or has a business agent in Taiwan is taxed as a domestic firm. Other foreign firms are subject only to a final withholding tax which is levied at 15, 20 or 25, 30 per cent depending on the type of income.	Capital losses may be used against other sources of income. Excess losses may be carried forward for five years.	Nil

Source: Various, see Chapter 1 (1.4.1).

12.7 CAPITAL GAINS

Singapore, Malaysia and Hong Kong do not impose a general form of capital gains tax (CGT) although Malaysia imposes a gains tax on the sale of real property and of shares in a real property company, defined as a company predominantly holding real property assets while Taiwan has a more general form of CGT.

Table 12.13: The taxation of capital gains — Malaysia and Taiwan

	Treatment of gains	Capital losses	Rollover relief
Malaysia Capital gains from real estate not treated as income of the individual and not subject to income tax. Capital gain is subject to real property gains tax and is taxed at a rate dependent on the time the asset was held.	**Shares** Not applicable unless the shares are held in a real property company. **Corporate bonds** n/a **Principal residence** Exempt for one property during lifetime. **Business assets** Not applicable (unless the business assets include real property, for which any gain will be subject to Real Property Gains Tax).	Capital losses only able to be offset against capital gains. Allowable to the extent that the loss (calculated as applicable rate times loss on sale) is offset against a future or current capital gain. Capital losses can be carried forward indefinitely but carry back is not allowed. Ordinary losses are not able to be deducted against capital gains.	**Replacement asset rollover** Available for transfer of (chargeable) assets held by an individual to a company controlled by the individual (for a consideration consisting of shares in the company or for a consideration consisting substantially of shares in the company and the balance of a money payment). **Same asset rollover** Rollover available to assets transferred between spouses or in the devolution of assets of a deceased person on his executor or legatee under a will or intestacy or on the trustees of a trust created under his will.
Taiwan Gains are taxed as part of personal income. No separate tax on capital gains except Land Increment Tax on sale of land.	**Shares** Exempt from income tax, losses not deductible. **Corporate bonds** Exempt from income tax, losses not deductible. **Principal residence** No separate CGT but gains are taxed together with other income at the personal rate. **Business assets** This gain is a part of personal income tax.	Losses from disposal of property are deductible only to the extent they can be applied to gains from disposal of property in the same tax year. Net capital losses can be carried forward for up to three years but only applied against future net capital gains. Carry back is not allowable.	No replacement asset rollover is available. Asset transfer between spouses is on a rollover basis under the estate and gift law.

Source: Various, see Chapter 1 (1.4.1).

12.8 INDIRECT TAXES

12.8.1 General consumption taxes

In relation to Hong Kong, Singapore, Malaysia and Taiwan, both Singapore and Taiwan currently levy a VAT. In Singapore, the standard VAT rate is 5 per cent, while in Taiwan the law provides that the VAT rate must not be lower than 5 per cent and not more than 10 per cent. The general VAT rate currently applicable in Taiwan is also 5 per cent.

Malaysia currently levies a sales tax on certain imported and locally manufactured goods, and a service tax on selected services. In its 2005 Budget, the Malaysian Government proposed replacing both these taxes with a single VAT-like consumption tax, which would be implemented on 1 January 2007 (the Malaysian Government has subsequently decided to defer implementation until a date to be determined).

Hong Kong does not currently levy a general sales tax but the Hong Kong Government recently announced[1] that it is also considering introducing a GST to develop a more stable source of revenue. The Hong Kong Government plans to announce detailed proposals and launch a public consultation process on introducing a GST in the middle of the year.

As in the OECD countries, Singapore and Taiwan exempt or apply a rate of zero to certain goods and services. Singapore also has a registration threshold of S$1 million. Table 12.14 shows examples of goods and services that have a zero VAT rate applied or are exempt in Singapore and Taiwan.

Table 12.14: Description of VAT systems — Singapore and Taiwan

	Zero-rated goods and services	Exemptions	Registration threshold
Singapore	Goods and services subject to a zero rate include: • exports; and • international telecommunications services.	Exempt goods and services include: • the sale or rental of residential properties; and • specified financial services.	An entity with an annual level of taxable supplies in excess of SG$1 million is required to register. Registration is allowed prior to exceeding the threshold.
Taiwan	Goods and services subject to a zero rate include: • exports; • vessels and aircraft used for international transportation; and • goods and repair services supplied to ships or aircraft used in international transactions, or ocean-going fishing boats.	Some of the major goods and services which are exempt include: • land; • water used for agricultural purposes; • health services; • educational services and academic books; • rice and wheat flour; • farm machinery and equipment; and • certain financial products and services.	

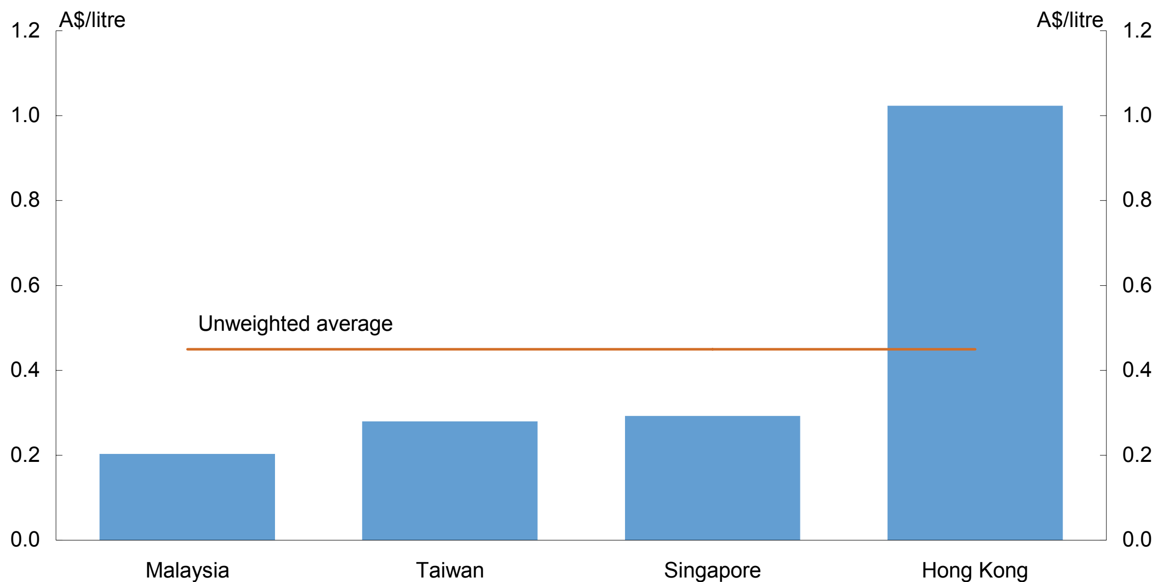
Source: Various, see Chapter 1 (1.4.1).

In Malaysia, the sales tax is levied at the manufacturing stage at a basic rate of 10 per cent. Some categories of goods have different rates applied, for example a rate of 5 per cent is applied to foodstuffs, and a rate of 15 per cent is applied to alcohol and cigarettes.

Chart 12.5 illustrates the unleaded petrol tax rates in Hong Kong, Malaysia, Singapore and Taiwan. This Chart contains information similar to that presented in Chart 8.7 on unleaded petrol tax rates in the OECD. In general the Asian economies charted have significantly lower unleaded petrol tax rates (unweighted average of A$0.449 per litre) compared to the OECD unweighted average (A$0.839 per litre).

1 Hong Kong Government (2006), 2006-07 Budget Highlights.

Chart 12.5: Unleaded petrol rates
Hong Kong, Malaysia, Singapore and Taiwan



Source: Various, see Chapter 1 (1.4.1).
Notes: Malaysia levies a specific sales tax on petrol. The sales tax rate on unleaded petrol is shown above (0.5862 ringgit per litre). Malaysia data for 2004; Taiwan, Singapore and Hong Kong data for 2005.

12.9 INTERNATIONAL TAXATION ARRANGEMENTS

This section briefly compares the international tax arrangements in the four Asian economies across a number of bases used to compare the arrangements of the OECD-10.

12.9.1 Residence

Table 12.16 shows the basis of the residence test for both individuals and companies for each of Hong Kong, Malaysia, Singapore and Taiwan. Most supplement their residence tests for both individuals and companies with substance-based tests.

Hong Kong is notable as not having a residence test for either individuals or companies as a result of having a 'pure' territorial system. Taiwan relies solely on the incorporation test to establish company residence. Malaysia and Singapore territorial tax systems are not as pure as that of Hong Kong's (see later sections) and hence have residency tests.

The Asian economies in Table 12.16 broadly apply similar residence tests to the OECD-10, with the exception of Hong Kong, which taxes only income arising within its borders, regardless of questions of residency.

Table 12.15: Residence tests for individuals and companies — Hong Kong, Malaysia, Singapore and Taiwan

	Tax residence test — individuals	Tax residence test — companies
Hong Kong	No residence test (residents and non-residents are treated the same).	Same as individuals.
Malaysia	Facts and circumstances; in practice high reliance on time present.	A company is a Malaysian resident if it is managed and controlled in Malaysia.
Singapore	Facts and circumstances; in practice, high reliance on time present.	A company is a Singaporean resident if it is managed and controlled in Singapore.
Taiwan	Facts and circumstances; in practice, high reliance on time present.	A company is a Taiwanese resident if it is incorporated in Taiwan.

Source: Various, see Chapter 1 (1.4.1).

12.9.2 Treatment of foreign source income

Treatment of an individual's foreign source income

Table 12.16 explains what constitutes temporary residency and compares the tax treatment of the income derived by temporary residents with that of ordinary resident and non-resident individuals for each of Hong Kong, Malaysia, Singapore and Taiwan.

The practice of these Asian economies deviates significantly from that found across the OECD-10. The focus among the Asian economies is on source taxation (that is, income sourced within its economy is taxable). In contrast, the general practice in the OECD-10 is to tax worldwide income of residents but with some exemptions (for example, for non-residents who may then only be assessable on locally sourced income).

Only Singapore has separate rules for temporary residents. The others either have a territorial tax system in relation to individuals (Hong Kong and Malaysia) or do not tax resident and non-resident individuals differently (for example Taiwan).

Table 12.16: Comparing tax treatment of temporary residents (expatriates) with resident and non-resident individuals — Hong Kong, Malaysia, Singapore and Taiwan

	Key temporary residence rules (expatriates)	Liability to tax	Tax rates	Tax base (including social security contributions/obligations of employees and employers)
Hong Kong	None	Residents: Hong Kong source income. Non-residents: Hong Kong source income.	Income: No difference between residents and non-residents. Capital gains: No capital gains taxes.	Income: No difference between residents and non-residents. There is no national health policy in Hong Kong. Employers can take up medical coverage for their employees; such benefits are not taxable to employees. If the employer provides a medical allowance in cash to the employee, the allowance is taxable as salary. Health insurance taken up by an individual is a personal expense and no tax deduction is available. Hong Kong does not have a social security system, any form of personal insurance taken up by an individual is a personal expense and no tax deduction is available. There is however a Mandatory Provident Fund, to assist in the provision of financial benefits for the workforce of Hong Kong when they retire. Legislation requires a mandatory contribution of 5 per cent from the employer and employee, subject to an annual contribution of HK$12,000. No contribution is required for taxpayers earning less than HK$5000 per month and visitors to Hong Kong for less than 13 months or if they are members of a similar scheme in their home countries. Capital gains: No capital gains tax.
Malaysia	None	Residents: Malaysian source income. Non-residents: Malaysian source income.	Income: Residents are taxed at a progressive rate up to 28 per cent. Non-residents are taxed at a flat rate of 28 per cent. Capital gains: Residents are taxed at zero to 30 per cent on real property depending on how long the asset has been held. Non-residents are taxed at 5 to 30 per cent on real property depending on how long the asset has been held.	Income: Non-residents are generally not entitled to claim personal reliefs. All Malaysian employers who have workers earning wages not exceeding 2,000 ringgit a month are required to contribute to a Compulsory Employment Injury Insurance Scheme (EIIS) and the Invalidity Pension Scheme (IPS) administered by the Social Security Organisation (SOCSO). For EIIS the contribution is borne solely by the employer (about 1.25 per cent of the wages of an employee). The IPS total contribution is about 1 per cent of the wages of an employee and is shared by the employee and employer. The SOCSO insurance schemes are only applicable to Malaysian citizens and permanent residents, so non-residents are not liable to contribute to SOCSO. There is an Employee's Provident Fund (EPF) which is a scheme to fund employees' retirement. The statutory rate of contribution for employees is 11 per cent (minimum) and 12 per cent for employers up to the maximum of 19 per cent. Most expatriates are required to contribute to the EPF. Capital gains: Residents have a zero per cent tax on capital gains from the sale of real property if disposal is after 6 years. Non-residents pay 30 per cent on capital gains from the sale of real property if disposal is within five years of acquisition, but only 5 per cent if disposal is after 6 years. Only gains from the sale of landed property and shares in real property companies are subject to real property gains tax.

Table 12.16: Comparing tax treatment of temporary residents (expatriates) with resident and non-resident individuals – Hong Kong, Malaysia, Singapore and Taiwan (continued)

	Key temporary residence rules (expatriates)	Liability to tax	Tax rates	Tax base (including social security contributions/obligations of employees and employers)
Singapore	Singapore has a Not Ordinarily Resident (NOR) scheme. NORs are tax residents that have not been a resident for three years prior to the year of assessment. A 5-year time limit applies.	Residents: Income derived from, accrued in or remitted to Singapore. Expatriates: Income derived from, accrued in or remitted to Singapore. Non-residents: Income derived from or accrued in Singapore.	Income: Residents are taxed at progressive rates up to 22 per cent. Non-residents are taxed on employment income at the higher of a flat 15 per cent or progressive rates up to 22 per cent; other income is taxed at a flat 22 per cent. Capital gains: No difference between residents and non-residents.	Income: Expatriates (that is NORs) get favourable treatment of pre-assignment income and overseas pension fund contributions. Also, partial exemption of foreign employment income. Non-residents are exempt from tax on certain securities and compulsory medical insurance system rights and obligations. Residents have access to certain personal and dependant tax reliefs. Singapore has a Central Provident Fund (CPF) which is a statutory saving scheme to provide for retirement and medical needs of employees. CPF contributions are compulsory for all *resident* employees working in Singapore. Contributions are payable on the employee's remuneration at the appropriate rates provided in the CPF Act (the rates vary depending on age). The contributions are allocated into three accounts (Ordinary account, Medisave account, and the Special account). Employee CPF contributions that are within the statutory limits are available as a tax relief against the statutory income of resident taxpayers. Capital gains: Exempt (residents and expatriates). Generally exempt (non-residents).
Taiwan	None	There is no difference between residents and non-residents: All individuals are taxed only on income derived in Taiwan (tax payable by non-residents on income derived in Taiwan is withheld and paid at source). Remuneration paid by employers outside Taiwan to non-resident employees whose stay in Taiwan does not exceed 90 days in a tax year is not considered to have a Taiwan source.	Income: Residents are taxed at progressive rates up to 40 per cent. Non-residents are subject to a final withholding tax (which varies from 0 to 30 per cent, depending on the characterisation of the income as a dividend, prize, income from retirement etc). Where a non-resident receives Taiwan source income, which is not subject to withholding procedure they are required to pay tax at 20 per cent on the gross income on their departure (or at end of tax year).	Income: Exempt employment income includes: salaries for military personnel in active service, foreign diplomats, foreign nationals, and teachers; salaries paid by foreign governments and organisations to foreign technicians and professors; scholarships granted by the Taiwan or a foreign government; and pensions. Taiwan has a mandatory National Health Insurance Scheme (NHI). Employees, employers and the Government pay premiums on a monthly basis based on the employee's reported income. The income percentage is approximately 4.25 per cent of the insured salary (the cost is shared 60 per cent by employers, 30 per cent by employees and 10 per cent by the Government). Employees must also pay the same rate for each dependent enrolled under their name for up to three dependants. Taiwan also has a system to finance retirement. Employers are required to deposit 6 per cent of an employee's monthly salary into the account (under the new Labour Retirement Pension Act). Employer contributions are a deductible expense and employee's can also contribute an amount of their pre-tax salary to the account. Capital gains: There is no separate capital gains tax in Taiwan, but, in general, all gains derived from transactions in property and property rights (that is, property situated in Taiwan) are taxable as ordinary income.

Source: Various, see Chapter 1 (1.4.1).

Treatment of a company's foreign source income

Table 12.17 shows the extent to which Hong Kong, Malaysia, Singapore and Taiwan tax the foreign income of their companies. Hong Kong has a pure territorial tax system and Malaysia and Singapore have extensive foreign income exemptions. Taiwan taxes its companies on a comprehensive worldwide basis without any unilateral exemptions. In contrast, the general practice amongst the OECD-10 is worldwide income taxation for resident companies but with some unilateral exemptions for specific types of foreign income (though around half of the OECD-10 also have no unilateral exemptions).

Table 12.17: Treatment of foreign source income of corporate residents — Hong Kong, Malaysia, Singapore and Taiwan

	Taxation of resident companies	Key foreign income exemptions from worldwide income taxation
Hong Kong	n/a Hong Kong has a territorial basis of taxation.	n/a The territorial basis on which Hong Kong generally levies tax serves to a large extent as a measure of unilateral relief from double taxation.
Malaysia	Malaysian resident companies are subject largely to territorial taxation only — income arising from sources outside Malaysia and received in Malaysia by resident companies is largely exempt from income tax. The only exceptions are resident companies carrying on the business of banking, insurance, shipping or air transport.	n/a The territorial basis on which Malaysia generally levies tax serves to a large extent as a measure of unilateral relief from double taxation.
Singapore	Singapore resident companies are not subject to tax on foreign dividends, branch profits and services income, provided that the source country taxes at a headline rate of at least 15 per cent.	n/a The territorial basis on which Singapore generally levies tax serves to a large extent as a measure of unilateral relief from double taxation.
Taiwan	Taiwanese resident companies are taxed on income from all sources worldwide.	None

Source: Various, see Chapter 1 (1.4.1).

Foreign tax credit (FTC) systems

Table 12.18 shows the key features of the FTC systems of Hong Kong, Malaysia, Singapore and Taiwan. Other than Taiwan, most have quite narrow FTC systems because of the extensive foreign income exemptions that exist. In comparison, the OECD-10 tend to provide various mechanisms for dealing with FTCs, which reflects their more general approach of taxing worldwide income.

Where available in the Asian economies, excess FTCs cannot be carried forward or back.

Table 12.18: Foreign tax credit systems comparison — Hong Kong, Malaysia, Singapore and Taiwan

	Key features of FTC system	Treatment of excess FTCs
Hong Kong	On the basis that foreign sourced income is not subject to tax in Hong Kong, FTCs are generally not available. Broadly however, if Hong Kong sourced income was also subject to foreign tax, or where foreign sourced income was submitted to tax in Hong Kong, a FTC may be available — provided that the foreign jurisdiction has an applicable double tax treaty (that is, Belgium and Thailand) or double tax arrangement with the Peoples Republic of China (PRC). Foreign tax which is an expense that must be borne regardless of whether or not a profit is derived is deductible not creditable. Typically such foreign tax takes the form of withholding tax on interest and royalties or is charged on the gross amount of the earnings, such as PRC Business Taxes.	No carry forward of foreign tax credits.
Malaysia	No formal system of foreign tax credits for foreign source income. Income taxed in Malaysia that is also subject to tax overseas may qualify for unilateral or bilateral credit relief. Unilateral credit relief (that is, non-treaty country) is capped to half the foreign tax payable on that income. Bilateral credit relief (that is, treaty country) is limited to the Malaysian tax payable. In both instances, credits are quarantined on a per-source basis.	No ability to carry forward their foreign tax credits.
Singapore	Income taxed in Singapore that is also subject to tax overseas may qualify for unilateral or bilateral credit relief. Unilateral credit relief (direct only) is available for foreign tax paid that is similar to Singapore tax in respect of: non-treaty Commonwealth countries that grant reciprocal relief; service income; dividends and branch profits. Where the foreign tax rate does not exceed 50 per cent of the Singapore rate, relief is granted in full. In all other cases the credit is capped at half the Singapore tax rate. Bilateral credit relief (direct only) for treaty countries is capped at an amount equal to net foreign income multiplied by the effective Singapore tax rate. Further, total FTCs, against income from all treaty countries, cannot exceed total Singapore tax. Credits may be quarantined on a per-country, per-income stream basis.	Excess credits cannot be carried forward or back.
Taiwan	Foreign tax paid is creditable against the total Taiwan income tax liability. The amount of the credit is limited to Taiwanese tax payable. Taiwanese are taxed on a cash basis when profits are remitted to Taiwan.	Excess credits cannot be carried forward or back.

Source: Various, see Chapter 1 (1.4.1).

12.9.3 Treatment of income of non-residents

Table 12.19 shows the way in which different types of income of non-residents are treated for tax purposes in Hong Kong, Malaysia, Singapore and Taiwan. Of the four economies, only Taiwan imposes dividend withholding tax on non-residents (as do most of the OECD-10). Only Hong Kong does not impose non-resident interest withholding tax (the other three Asian economies apply interest withholding arrangements similar to those across the OECD-10). All four economies impose non-resident royalty withholding tax and other withholding taxes (charged to non-residents on a gross basis).

Table 12.19: Treatment of income of non-resident taxpayers[(a)] — Hong Kong, Malaysia, Singapore and Taiwan

	Withholding tax on dividends paid to non-residents	Withholding tax on interest and royalties paid to non-residents	Withholding tax on other income paid to non-residents
Hong Kong	Hong Kong does not impose dividend withholding tax.	Hong Kong does not impose interest withholding tax. Royalties are chargeable to withholding tax if the relevant intellectual property is for use or used in Hong Kong, or if a deduction has been claimed for the royalties. Royalties are generally subject to Hong Kong royalty withholding tax at a rate of 5.25 per cent.	Consignment sale proceeds to foreign consignors are subject to withholding tax at 1 per cent, although in practice only 0.5 per cent of the gross proceeds is demanded.
Malaysia	No withholding tax on dividends.	Interest 15 per cent. Royalty 10 per cent. Subject to reduced treaty rates.	Technical services income at 10 per cent but subject to reduction under the treaty for services rendered in Malaysia.
Singapore	No withholding tax on dividends.	Interest payments to non-residents are taxed at 15 per cent and may be reduced by applicable double tax treaties (mostly to 10 per cent, but Mauritius and South Africa at zero per cent). Royalty withholding tax at 10 per cent. Rental of moveable property at 15 per cent, subject to reduction under treaties.	Equipment leasing rents are subject to 15 per cent withholding tax. Management fees and technical fees are subject to 20 per cent withholding tax. Rental of movable assets is subject to 15 per cent withholding tax. Charter fees subject to tax ranging from zero to 3 per cent.
Taiwan	Corporates are charged 20 per cent if approval from Investment Commission or Ministry of Economic Affairs under the Statute for Investment by Foreign Nationals. Subject to treaty reduction. There is a 10 per cent surtax on undistributed profits, creditable against the withholding tax. There is a franking credit system so no further withholding tax if franked.	Interest and royalty payments to non-residents are taxed at 20 per cent. Subject to treaty reduction.	If no permanent extablishment, foreign residents have 20 per cent withheld on all amounts of Taiwanese sourced income.

(a) The table does not deal with income which is taxed on a net basis such as where it is attributable to a permanent establishment.
Source: Various, see Chapter 1 (1.4.1).

Treatment of conduit foreign income

With the exception of Taiwan, conduit income is generally taxed lightly, if at all. Only Taiwan imposes non-resident withholding tax and only Taiwan broadly taxes its companies on their worldwide income. Where there are two or more resident companies in the conduit income chain, dividends are exempt from tax in the hands of the recipient in Hong Kong, and Singapore is in transition from an imputation system to one where dividends will be exempt in the hands of all shareholders.

12.9.4 Attribution and other international tax integrity rules

Table 12.20 shows the attribution and other international tax integrity rules used by Hong Kong, Malaysia, Singapore and Taiwan. None of these economies have attribution rules or specific tax integrity provisions (although general integrity measures exist for all four countries). The absence of specific provisions is at variance with the general approach across the OECD-10.

Table 12.20: Attribution and other international tax integrity rules — Hong Kong, Malaysia, Singapore and Taiwan

	CFC rules	FIF or other attribution rules	Thin capitalisation rules	Transfer pricing rules
Hong Kong	No	No	No specific rules, although there are stringent conditions for the deductibility of interest which may effectively restrict the use of overseas debt finance.	No specific rules, although tax authorities may adjust transaction prices between related parties if arm's length principle has not been observed.
Malaysia	No	No	No specific rules, although the tax authorities may disallow interest to the extent that it is not used to finance assessable operations.	No specific rules, although tax authorities may adjust transaction prices between related parties if arm's length principle has not been observed.
Singapore	No	No	No specific rules, although the tax authorities may disallow interest to the extent that it is not used to finance assessable operations.	No specific rules, although tax authorities may adjust transaction prices between related parties if arm's length principle has not been observed.
Taiwan	No	No	No specific rules, although tax authorities may adjust transaction prices between related parties if arm's length principle has not been observed.	No specific rules, although tax authorities may adjust transaction prices between related parties if arm's length principle has not been observed.

Source: Various, see Chapter 1 (1.4.1).

12.9.5 Tax treaties

Table 12.21 shows the network of treaties in place, their type and key attributes for each of Hong Kong, Malaysia, Singapore and Taiwan. As the table indicates, all their treaties are based on the OECD Model, although only Malaysia and Singapore have an extensive treaty network. Only Malaysia departs from the OECD Model to any significant degree.

Table 12.21: Tax treaties — Hong Kong, Malaysia, Singapore and Taiwan

	Network	Model predominantly relied on	Key departures from model (with respect to permanent establishments, business profits, withholding taxes and alienation of property)
Hong Kong	Full scope treaty with Belgium and Thailand. Arrangement with China.	OECD	No key departures noted.
Malaysia	61	Appears to be based on OECD with some modifications.	**Permanent establishments/business profits** • Malaysia maintains strong source country taxing rights for determining what constitutes a Permanent Establishment. **Withholding taxes** • Malaysian tax treaties generally contain a 10 per cent withholding rate on royalties.
Singapore	81	OECD	No key departures noted.
Taiwan	16	OECD	No key departures noted.

Source: Various, see Chapter 1 (1.4.1).

Chapter 13

Administration and compliance costs of taxation

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13. ADMINISTRATION AND COMPLIANCE COSTS OF TAXATION

SUMMARY

Operating costs are a necessary part of raising revenue. The issue is what the appropriate level of operating costs should be. Operating costs are justified where the costs of raising the tax (including efficiency costs) are outweighed by the net benefits.

There have been few truly comparative international operating cost studies. The main reason for this is that cross-country comparisons are difficult to conduct and need to be treated with caution. Researchers have commented that international comparisons in this particular area are 'more likely to mislead than enlighten' (Sandford 1995, p 405).

As a result of these difficulties no summary is made of the various studies that estimate operating costs across countries. Instead, the focus of this chapter is to provide a discussion on operating costs and to highlight some of the difficulties in making international comparisons.

The report notes that the Board of Taxation has commenced a scoping study of tax compliance costs facing the small business sector in Australia, which will be presented to the Treasurer during the second half of 2006.

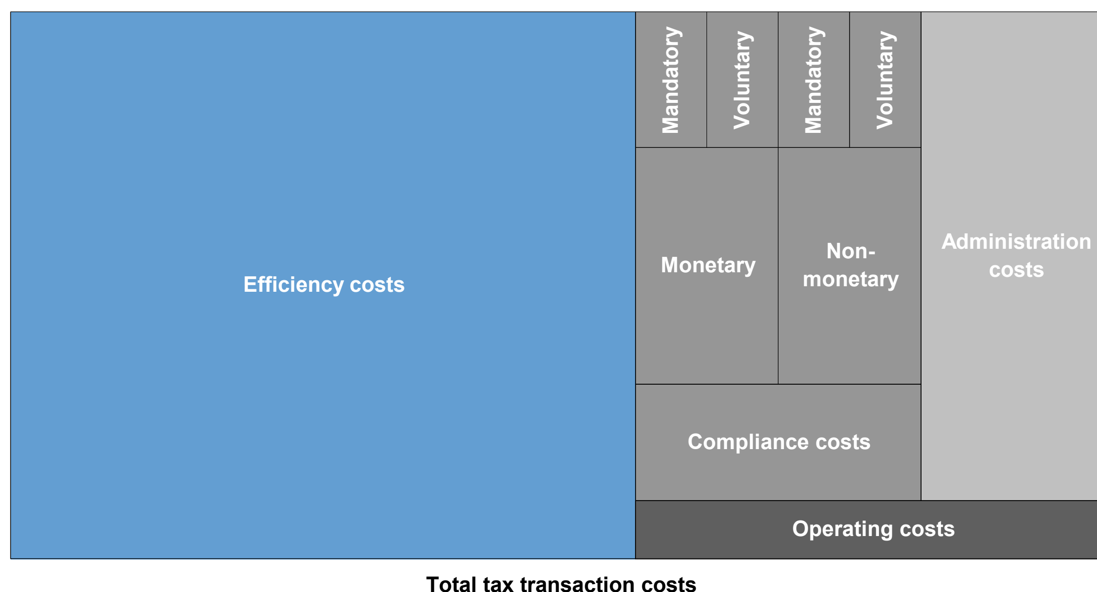
13.1 INTRODUCTION

The various measures of tax burden outlined in the previous chapters do not provide a complete picture of the impact of taxes on society or the economy. Collecting taxation revenue generates two types of costs: efficiency costs and operating costs. Efficiency costs refer to costs arising from distortions in the allocation of resources owing to the imposition of the tax, while operating costs refer to both:

- administration costs, which are the costs to the government of collecting revenue; and
- compliance costs, which are the costs (both monetary and non-monetary) incurred by taxpayers in meeting their tax obligations.

Chart 13.1 provides a schematic representation of the types of costs incurred in raising revenue. Previous chapters have focused on tax design features of the revenue system — each of which include aspects of efficiency. The focus of this chapter is on operating costs.

Chart 13.1: A breakdown of tax transaction costs



Source: Oliver and Bartley (2005).

Operating costs are a necessary part of raising revenue. The issue is what the appropriate level of operating costs should be. Operating costs are justified where the costs of raising the tax (including efficiency costs) are outweighed by the net benefits.

Compliance costs cover a range of both monetary and non-monetary costs. They include the costs of: acquiring the necessary knowledge of relevant aspects of the tax system; compiling records; acquiring and maintaining tax accounting systems and completing tax return forms; evaluating the tax effectiveness of alternative transactions or alternative methods of complying with the requirements of the law; and collecting and remitting taxes levied on employees and turnover. Monetary costs are those which are incorporated into a businesses' financial performance and are likely to be reflected in business profits. Non-monetary costs are less tangible costs that are less likely to be reflected in short term profits, but which may impact on short-term incentives and longer-term performance.

Compliance costs may also be either mandatory or voluntary. Mandatory costs are those that taxpayers must incur to meet their statutory obligation such as reporting particular types of income or being able to substantiate deductions claimed. Voluntary costs are additional costs that the taxpayer may choose to incur to determine or minimise their tax liability. For example, taxpayers may choose to evaluate alternative methods of complying with the law to determine which produces the most favourable tax outcome. They may also seek advice to identify tax effective ways to structure transactions.

Administration costs form part of the costs of the public sector and cover the costs of implementing tax policy, and revenue collection by the revenue authority (for example, the Australian Taxation Office). They include the costs of collecting taxation revenue and providing assistance and guidance to taxpayers.

Although recognition of the existence and impact of tax operating costs is not new, research into determining the level of operating costs, and compliance costs more specifically, has emerged only over the past 20-25 years. Two major studies of taxpayer compliance costs have been conducted in Australia, both focused at the 'macro' level. These studies are, the

1997 ATAX study, for the Australian Taxation Office (ATO) by Evans, Ritchie, Tran-Nam and Walpole (1997, 1998), which is based on the 1994-95 fiscal year, and earlier studies by Pope et al (1990, 1991, 1992, 1993, 1994). There has been no major study in Australia following the introduction of *The New Tax System*.

13.2 COMPARING OPERATING COSTS ACROSS COUNTRIES

There have been few truly comparative international operating cost studies. The main reason for this is that cross-country comparisons are difficult to conduct and need to be treated with caution. This is particularly the case for comparisons that involve multiple countries over long periods. Sandford (1995, p 405) noted that international comparisons are 'more likely to mislead than enlighten'.

The difficulties in producing meaningful comparisons of tax operating costs across countries are well known and documented. Many things can affect the measurement of operating costs which have little to do with the actual operating costs in a given country, including:

- differences in data quality arising for example, from variations in response rates, validation procedures or questions;
- definitional issues arising from differences in perceptions on what constitutes a compliance cost;
- differences in tax structure including variations in tax relief or thresholds;
- the makeup of the tax population including variations in the number of self employed;
- differences in rates of tax which can have a significant impact on cost to revenue ratios;
- fluctuations in revenue collections over the business cycle; and
- preference for tax expenditures over direct expenditure. For example, where benefits are provided through the tax system compliance costs will increase and revenue will decrease (Sandford 1995, p 406).[1]

Many studies of tax operating costs focus solely on compliance costs, and exclude administration costs. Given there is scope to transfer costs between the private and public sectors, compliance costs could be reduced at the expense of administration costs by expanding the role of the tax office. Conversely administration costs could be reduced, for example through self assessment at the expense of compliance costs. As such, it is important to consider both compliance and administration costs.

International comparisons need to allow for the decision made on the distribution of costs between taxpayers and the tax administrator, and for the types of trade offs between these costs and other and other tax objectives.

1 Sandford raised these issues in relation to calculating the compliance costs to revenue ratio, however, they apply equally to other measures of tax operating costs.

Similarly, there may be trade-offs between achieving equitable or efficient outcomes and compliance and administration costs. In many cases, compliance or administration costs (or both) can be reduced using more 'rule of thumb' approaches, at the expense of achieving precisely equitable or efficient outcomes.

13.3 International comparisons

The limitations outlined above do not mean international comparisons should not be made. The primary use of international comparisons of compliance cost has been to establish the reliability of internal assessments rather than to identify differences across countries. Evans (2003) provided a summary of administration and compliance costs studies undertaken over the past 20 years.

13.3.1 Compliance costs

One of the main findings by Evans (2003) was that compliance costs are significant for the main central government taxes such as personal income tax, corporate income tax and value added taxes (GST). Compliance costs for such taxes are generally found to be between 2 to 10 per cent of the revenue yield and in total are generally up to 2.5 per cent of GDP.

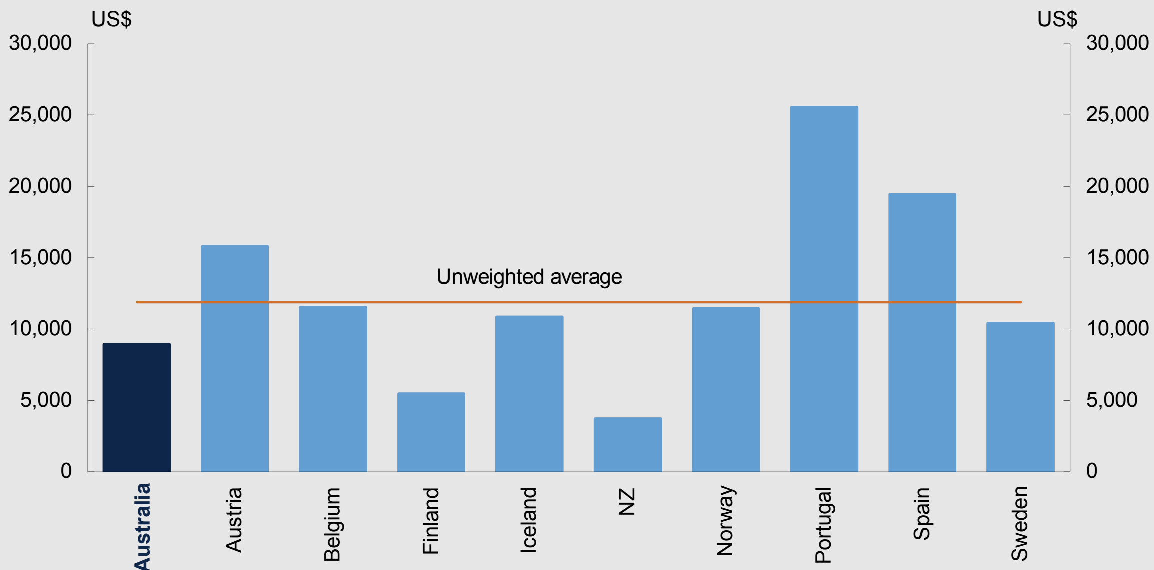
Box 13.1: Compliance costs faced by small and medium sized business — OECD study

In 1998-99, the OECD undertook a study on the administrative and regulatory burdens faced by small and medium enterprises (SMEs) (OECD, 2001). The study covered 11 countries, Australia, Austria, Belgium, Finland, Iceland, Mexico, New Zealand, Norway, Portugal, Spain and Sweden.[2] The OECD study was able to overcome some of the limitations identified in section 13.2: it used a standardised methodology across all countries. Despite this, limitations still exist and the results should be treated with care, in particular, the study is based on 1998-99 data and does not reflect any possible significant changes in tax systems across OECD countries since that time.

The OECD study was not limited to tax compliance costs. Rather, it included three areas of regulation: tax, employment and environmental regulation.

As shown in Chart 13.2, tax compliance costs per SME varied significantly across the countries surveyed. The highest was Portugal which had an average compliance cost per SME of US$25,545, the lowest was New Zealand which had an average of US$3,706 per SME. Australia's average tax compliance costs per SME at the time of the survey were estimated to be around US$8,922.

Chart 13.2: Tax compliance costs — average per SME
Selected OECD countries, 1998-99 (US dollars)



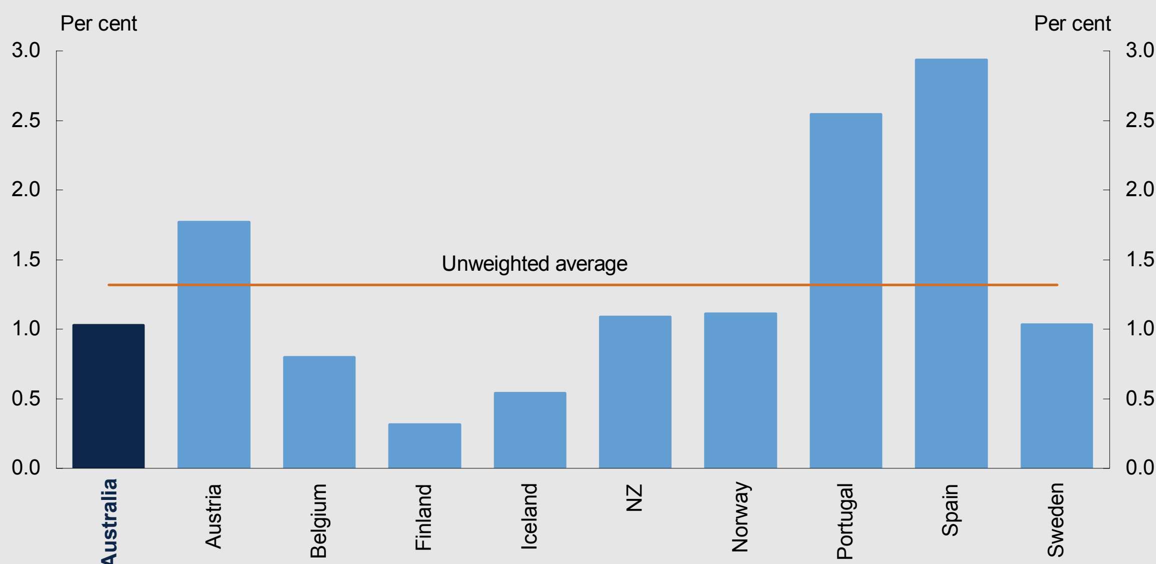
Source: Australian Treasury estimates based on OECD unpublished data.

Chart 13.3, illustrates tax compliance as a percentage of GDP. It shows that all countries commit a significant proportion of their economic resources to tax compliance. Based on the OECD data, it is estimated that tax compliance costs incurred by SMEs in Australia was around 1 per cent of GDP, slightly below the average of 1.3 per cent in 1998-99.

2 Data for Mexico was not reported.

Box 13.1: Compliance costs faced by small and medium sized business — OECD study (continued)

Chart 13.3: Tax compliance costs as percentage of GDP
Selected OECD countries, 1998-99



Source: Australian Treasury estimates based on OECD unpublished data.

Measuring tax compliance costs as a percentage of annual turnover, Australia's rate of 0.4 per cent was the second lowest and around one percentage point lower than the average of the surveyed countries (1.7 per cent).

13.3.2 Administration costs

As noted previously the usefulness of an examination of compliance costs on its own is limited. Given the scope to transfer costs between the private and public sectors, compliance costs could be reduced at the expense of administration costs by expanding the role of the tax office. This section examines tax administration costs.

Administration costs are usually measured as part of the costs of the public sector. Even though this should provide a basis for making comparisons, the standard and comprehensiveness of measures varies over time and across governments (Evans 2003, pp 64-65). Revenue authorities around the world face differing environments in which they operate. Countries differ greatly in respect of their policy and legislative environment and their administrative practices and culture (OECD 2004, p 4). These are in addition to the limitations outlined in section 13.2.

There have been few studies into tax administration costs. Evans (2003), who provided a summary of over 60 major administration and compliance costs studies since 1980, identified only one solely concerned administration costs, while only around a quarter considered both administration and compliance costs.

Of the studies that included administration costs, Evans (2003) found that they rarely exceed 1 per cent of the revenue yield and were usually well below 1 per cent. Evans concluded that 'administrative costs are absolutely and relatively less burdensome than compliance costs' Evans (2003, p 72).

Box 13.2: Comparison of administration costs — OECD study

The OECD (2004) information series paper provides internationally comparative data on many aspects of tax systems and their administration throughout the OECD. The report provides a limited number of operation performance information that is often used in international comparisons of tax administration systems, including:

- the 'cost of collection' ratio, which is computed by comparing annual administration costs with revenue collected; and
- relative staffing levels.

The OECD study highlights the limitations with making international comparisons of tax administration costs using these approaches (OECD 2004, pp 24-26). Many of these qualifications were outlined in section 13.2. In particular, the OECD notes the data presented 'should be interpreted with considerable care and take account of the abnormal factors highlighted, as well as other differences in approach to revenue administration' (OECD 2004, p 26).

The following section is based on the 2004 OECD study, focusing on the cost of collection ratio for the OECD-10 (excluding Switzerland).

Table 13.1: Cost of collection ratio — OECD-10, 2000 to 2002

	Administration costs/net revenue collections (%)			Factors likely/known to influence reported ratio
	2000	2001	2002	
Australia	1.11	1.27	1.19	Start up/implementation costs of the GST for 2000/2001.
Canada	1.07	1.08	1.20	
Ireland	0.81	0.90	0.95	Includes customs costs and revenues (for example, VAT on imports); includes social security contributions.
Japan(a)	1.42	1.54	1.62	Relatively low burden (that is, less than 30 per cent); revenue base excludes separately collected social contributions; substantially reduced administrative workloads due to features of tax system (see OECD, 2004).
Netherlands	1.70	1.74	1.76	Costs include customs administration; revenue base includes social contributions.
New Zealand	1.44	1.21	1.17	
Spain	-	0.81	0.78	
Switzerland	-	-	-	
United Kingdom - IRD	1.10	1.11	1.15	Includes all staff of national contributions agency.
United States(b)	0.43	0.46	0.52	Revenue base includes social contributions.

(a) Data as reported in 2002 annual report.
(b) Ratios indicated vary from IRS-published ratios of 0.39 (2000), 0.41 (2001), and 0.45 (2002) owing to use of 'net' and not 'gross' collections.
Source: OECD (2004).

Box 13.2: Comparison of administration costs — OECD study (continued)

Table 13.1, presents estimates of the cost of collection ratios from 2000 to 2002 for the OECD-10 (excluding Switzerland). It highlights the variation in the ratio across the nine countries. The Netherlands consistently had the highest ratio across the OECD-10 (1.7 per cent and above), while the United States had the lowest ratio over the period (from 0.43 to 0.52 per cent). Australia lies in between (from 1.11 to 1.27 per cent) although the estimates include the once-off start-up and implementation costs associated with the introduction of the GST.

13.4 MEASURES TO REDUCE COMPLIANCE COSTS

Studies into compliance costs have created substantial public interest. In response to these studies and concerns by small business in particular, governments have begun introducing measures to monitor compliance costs, limit incremental compliance costs and where possible, reduce existing compliance costs. Some of the initiatives that have been adopted by governments include:

- requirements that all new tax legislation be supported with a form of tax compliance cost impact statement;
- introduction of programmes and guidelines to improve the clarity of legislation;
- establishment of specific government bodies or external taskforces tasked with advising governments on the effectiveness of regulatory measures and identifying ways of minimising regulatory compliance;
- introduction of public consultation guidelines on the development and implementation of new policies;
- establishment (or development) of methods or models to measure the regulatory burden of new laws or regulations; and
- introduction of specific compliance cost reduction targets.

The measures are not targeted solely at tax legislation, but instead cover the broader regulatory and administrative burden faced by individuals and business.

In November 2005, the Board of Taxation commenced a scoping study of tax compliance costs facing the small business sector in Australia. The Board's report will take into account:

- the purpose and object of the law;
- the relationship between taxpayer compliance costs and government administration costs;
- costs incurred by business for non-tax reasons and any additional costs incurred by businesses or their advisors for tax reasons (tax compliance costs);
- transitional costs and ongoing tax compliance costs;

- taxpayer circumstances and commercial practices;
- other legislation; and
- any other matters the Board considers materially impact on small business tax compliance costs.

The final report will be presented to the Treasurer during the second half of 2006.

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Chapter 14

Tax expenditures

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14. TAX EXPENDITURES

SUMMARY

Most OECD countries estimate tax expenditures. While tax expenditure estimates provide important information for evaluating the extent of government assistance to particular taxpayers and activities, care needs to be taken in interpreting the results, especially tax expenditure aggregates. Differences in tax systems and benchmarks make international comparisons of tax expenditures particularly difficult.

As a result of these difficulties no attempt is made to compare estimates of tax expenditures across countries. Instead the focus of this chapter is to provide a comparison of tax expenditure reporting across selected OECD countries.

The Australian Treasury publishes an annual Tax Expenditures Statement (TES) summarising Australian Government tax expenditure estimates. The 2005 TES listed around 270 tax expenditures with an estimated value of around $37 billion or 4.1 per cent of GDP in 2004-05 (Treasury 2005). This level has remained broadly constant over the past five years and is projected to remain so.

Australia's approach of having a legal requirement to analyse tax expenditures, linking it to the government budget cycle, and covering a broad range of taxes appears to be in line with the approach followed by most OECD countries.

14.1 INTRODUCTION

As discussed in Chapter 2 the main objective of any taxation system is to raise revenue to fund government activities.

The tax system also provides government with the opportunity to promote objectives other than revenue raising. A government can achieve some of these objectives by reducing taxes in selected areas to provide incentives for economic activities and to direct assistance (in the form of lower taxes) to particular groups, individuals, businesses or activities.

A tax expenditure is a tax concession that provides a benefit to a specified activity or class of taxpayer. A negative tax expenditure occurs when an additional charge is imposed rather than a benefit provided. Most tax expenditures provide a benefit to the taxpayer.

A tax expenditure can be provided in many forms, including tax exemption, tax deduction, tax offset, concessional tax rate or deferral of a tax liability.

Not all programmes delivered through the taxation system are regarded as tax expenditures. In Australia, a number of programmes which are delivered through the taxation system have been classified as direct expenditures under the Australian System of Government Finance Statistics (GFS) and are not counted as tax expenditures (ABS 2005). These include a number

of refundable tax offsets, for instance, the Family Tax Benefit, the Research and Development Tax Offset and the Private Health Insurance Tax Offset.

The statistical concepts and classification principles used by the Australian Bureau of Statistics in compiling the GFS are based on an International Monetary Fund standard. Under the GFS classification, programmes delivered through the taxation system are not treated as part of the taxation system (and therefore as giving rise to tax expenditures) unless they are integral to the taxation system.

Direct expenditures could be used to deliver most tax expenditures. Tax expenditures deliver benefits through the taxation system and affect the budget position in a similar way to direct expenditures. Tax expenditures may be preferable to direct expenditures in promoting some government policy objectives. The advantages of using tax expenditures rather than direct expenditure include:

- they can influence private activity by affecting prices or returns, leaving decisions on the extent of participation to private decision makers; and
- they can reduce the extent of direct government supervision required of a policy.

The disadvantages of tax expenditures over direct expenditures include:

- there is usually a much lower level of public accountability for tax expenditures relative to direct expenditures. Expenditures through the annual budget tend to be scrutinised closely as part of the annual budgetary cycle;
- taxes affect prices, including tax concessions. There can be difficulties in setting the correct level of taxes or tax concessions to use prices to correct market failures. They may be ineffective in achieving specific objectives, including by under or overshooting the desired outcome or by offsetting the effect of other policy instruments;
- tax expenditures may be difficult to contain and may lead to erosion of the tax base over time as different groups compete for concessions;
- tax expenditures generally add to the complexity of the tax system; and
- tax expenditures make it more difficult to evaluate the size of government, both over time and in comparisons with other jurisdictions. For instance, pursuing government policies through tax expenditures can reduce both tax and direct expenditures, making government look smaller than if the same policies were pursued through direct expenditures.

Currently, the majority of OECD countries report on tax expenditures. Reporting on tax expenditures serves several functions, including:

- allowing tax expenditures to receive a similar degree of scrutiny as direct expenditures;
- allowing for a more comprehensive assessment of government activity; and
- contributing to the design of the tax system, by promoting and assisting the public debate on all elements of the tax system.

The Australian Government has recognised the importance of tax expenditure reporting by making it an integral component of its budget reporting and a requirement under the *Charter of Budget Honesty Act 1998*.

14.2 MEASURING TAX EXPENDITURES

As outlined in the 2005 TES, tax expenditures can be measured in three principal ways:

- The *revenue forgone approach* which measures how much taxation revenue is reduced (relative to a benchmark) because a tax expenditure exists. It compares the current and/or prospective treatment and the benchmark treatment, assuming taxpayer behaviour is unchanged.

- The *revenue gain approach* which measures how much revenue could increase if a particular tax concession were removed. Accurate estimation of this cost would require estimates of the secondary or behavioural effects associated with such a change.

- The *outlay equivalence approach* which measures how much direct expenditure would be needed to provide a benefit equivalent to the tax expenditure. This approach measures the expenditure required, in pre-tax dollars, to achieve the same after-tax dollar benefit as a tax expenditure where the direct expenditure receives the tax treatment appropriate to that type of income in the hands of the recipient.

In addition, as indicated in Table 14.1, Australia and some other countries use an accruals framework, while other countries use a cash basis.

The different methodologies used to measure tax expenditures can result in significantly different estimates of their value.

While the revenue gain approach would be most consistent with budget estimates, it also requires substantial information regarding behavioural responses and interactions with the rest of the tax system as well as assumptions regarding the order of tax expenditures. This becomes extremely complex (and arbitrary) as the number of tax expenditures in a system increases.

Australia uses the revenue forgone approach to calculate tax expenditures, which is consistent with the approach used in most OECD countries that report tax expenditures. It is the most reliable method of estimating the level of assistance the tax system provides to taxpayers. The revenue forgone approach calculates tax expenditures as the difference in tax paid by taxpayers who receive a particular concession relative to a benchmark that incorporates structural elements of the tax system and is representative of similar taxpayers who do not receive that concession.

As noted in the TES, care should be taken in interpreting estimates of tax expenditures calculated by the revenue forgone method because the estimates of reported tax expenditures are not necessarily reliable indicators of the budgetary impact of removing particular tax concessions. Furthermore, aggregated estimates of tax expenditures are not reliable indicators of the total value of tax expenditures and should only be taken as broad indicators of trends in the value and composition of tax expenditures over time.

Care should also be taken in comparing the level of tax expenditures reported in different editions of the tax expenditures statements, both for individual tax expenditures and in aggregate. Changes may arise for reasons that do not reflect any change in the actual magnitude of tax expenditures, such as revisions to data, changes in methodology, identification of formerly unidentified tax expenditures, quantification of previously unquantified tax expenditures, and deletion of abolished tax expenditures.

For similar reasons, comparisons of the level of tax expenditures between countries are difficult. Differences in tax systems, benchmarks, classification systems and coverage of estimates mean that comparisons of the value of tax expenditures between countries (in monetary or proportional terms) are unlikely to be meaningful.

For example, benchmarks could be based on either a comprehensive income approach or an expenditure approach. In turn, these can be based on a nominal approach (no account taken of the impacts of inflation) or a real approach (account taken of inflation). In addition, the base can be determined around accrued income (income is recognised as the price of assets and liabilities change) or on a realisations basis (changes in asset values recognised at the time of sale). Australia bases its tax expenditures on a comprehensive, nominal, realisation basis. Use of another tax benchmark would produce very different results in terms of the absolute magnitudes of tax expenditures and their composition.

14.3 TAX EXPENDITURE REPORTING IN THE OECD

In the early 1970s, only Germany and the United States reported tax expenditures. By 1983, Australia, Austria, Canada, France and Spain were also regularly identifying tax expenditures. Currently, the majority of OECD member countries report tax expenditures; most, including Australia, report tax expenditures annually.

In general, most OECD countries that report tax expenditures do so for personal and business income taxes and value added taxes, where applicable. Australia, like Belgium, France, Germany, Netherlands, United Kingdom and the United States, reports tax expenditures on the majority of central government direct and indirect taxes. Austria and Italy report tax expenditures at all levels of government.

Of the OECD countries that report tax expenditures, at least nine have noted the importance of reporting and made it a legal requirement. These countries include Australia, Austria, Belgium, France, Germany, Italy, Portugal, Spain and the United States. In addition, most of these countries explicitly link tax expenditure reporting to the budget process.

Table 14.1 is reproduced from a World Bank Study (Brixi, Valenduc and Li Swift 2003) and provides details of the basis of tax expenditure reporting in 10 OECD countries (note that only five of these countries, including Australia are in the OECD-10 comparator group). Table 14.2, from the same study, provides details of what is included in the tax expenditure statements of various countries.

In summary, Australia's approach of having a legal requirement to analyse tax expenditures, linking it to the government budget cycle, and covering a broad range of taxes appears to be in line with the approach followed in most OECD countries.

Table 14.1: Tax expenditure reporting — a comparison among 10 selected OECD countries

Country	Purpose/usage	Legal requirement	Relationship with budget	Frequency	Method of estimation
Australia	Facilitating assessing tax expenditures alongside direct expenditures; contributing to the design of the tax system; informing the public debate.	Legally obliged	A separate government document with a summary in the budget.	Annually	Revenue foregone method on an accruals basis.
Austria	Tax reform and facilitating budget process.	Legally obliged	As an annex, part of 'Subsidy Report' to budget documents.	Annually	Revenue foregone method on an accruals basis.
Belgium	Assessing the impact of various tax measures on revenue.	Legally obliged	An annex to budget.	Annually	Revenue foregone method on a cash basis.
Canada	(1) Analysing federal income tax and VAT systems. (2) Pre-budget consultations.	No statutory obligation	Not linked to budget process, but for pre-budget consultation.	Annually	Revenue foregone method on cash basis.
France	Facilitating the budget process.	Legally obliged	Appended to budget bill.	Annually	Revenue foregone method on a cash basis.
Germany	Subsidies/expenditure reduction.	Legally obliged	As a part of budget, called 'Subsidy Report'.	Biennial	Revenue foregone method on a cash basis.
Italy	(1) Evaluating tax expenditure on the basis of its cost, objective criteria, and its consistency with budget. (2) Evaluating its effects for particular sectors and geographical areas, compared with their original aims. (3) Being in line with EC tax expenditure policy guidance.	Legally obliged	Not linked to budget process, nor as annex to budget document. But an independent document.	Sporadically	Revenue foregone method on an accruals basis.
Netherlands	Providing the Parliament with insight into budgetary cost of tax expenditures, and possible budgeting.	Not legally obliged	As an annex to the Budget Memorandum. Not directly linked to the budget but serves as additional background information for the Parliament.	Annually	Revenue foregone method on an accruals basis.
United Kingdom	Facilitating annual budget discussion/debate.	No statutory obligation, but as a recommendation from the Expenditure Committee	Not linked to budget process, nor as annex to budget document. But as part of statistical supplement to Autumn Statement (revenue).	Annually	Revenue foregone method, on an accruals basis.
United States	(1) Shaping tax reforms. (2) Deficit reduction.	Legally obliged	As part of annual budget documents, but is not integrated into the budget process.	Annually	Revenue foregone, outlay equivalent, and present value methods, on a cash basis.

Source: Brixi, H, Valenduc, C and Li Swift, Z (2003, pp 10-11).

Table 14.2: Coverage of tax expenditures report — a comparison of 10 selected OECD countries

		Coverage		
Country	Definition and inclusions in Report	Types of taxes	Levels of Government	Classification
Australia	A formal definition of a tax expenditure is used and the 'norm' is applied.	Personal income tax; retirement benefits tax; fringe benefits tax; business tax; and excise tax.	Commonwealth Government (Central Government)	By broad economic function; by type of taxpayer affected; and by the particular benchmark to which they relate.
Austria	Using tax norm to define tax expenditures or 'indirect subsidy'. Also using three-way classification in tax expenditures, relief in benchmarks and some in between or combination of the two.	Direct and indirect taxes.	All levels of governments	By types of taxes; and by beneficiary.
Belgium	Tax expenditure is defined as a deviation from the benchmark system resulting in a loss of revenue. The Report includes all exemptions, deductions, and allowances that affect government revenues.	Personal income tax; corporate tax; excise taxes; mortgage registry fees; value added tax; annual tax on insurance policies.	Federal Government	By whether or not it constitutes a tax expenditure; by type of taxes; by intended purpose.
Canada	Using a very narrow definition of the 'norm', in which only the most fundamental structural elements of the tax system are considered to be part of the benchmark. The Report includes both tax preferences which are structural items, non-structural items.	Personal income tax; corporate income tax; goods and service tax.	Federal Government	By (1) personal income tax: by budgetary functional category; (2) corporate income tax: by industry, then broken down by industrial sector; and (3) VAT, by four categories: zero-rated, tax-exempted, tax rebates and tax credits.
France	A formal definition of a tax expenditure is used and the 'norm' is applied.	Income tax; income tax and corporate tax; corporate tax; registry fees and stamp duty; VAT; payroll tax; internal tax on the consumption of petroleum products.	Central Government	By types of the tax; by main purposes; and by beneficiary.
Germany	Uses 'Subsidy Report,' which includes both direct subsidies and tax concessions.	Income tax; corporate tax; net worth tax; business tax; turnover tax; company tax; insurance tax; motor vehicle tax; excise taxes; betting and lottery tax; property tax; inheritance tax.	Federal Government	By industrial sector; within these sectors, a further classification by tax type.
Italy	All favourable tax treatment provisions, which include both structural and non-structural.	Personal and corporate direct taxes; value-added tax; excises; customs duties; and other indirect taxes.	Both Federal and local governments	By type of taxes; main sectors involved; the aim; beneficiaries; and their locality.
Netherlands	Formally defined as a loss or deferment of taxation revenue resulting from a tax provision insofar this tax provision is not in accordance with the benchmark tax structure. For defining the benchmark tax structure a rather pragmatic approach is used.	Wage and income taxes; corporate tax; VAT; excise taxes; energy tax; motor vehicle tax; estate and gift tax; and social insurance contributions.	Central Government	By purpose of tax expenditure (direct taxes); and by type of taxes (indirect taxes).

Table 14.2: Coverage of tax expenditures report — a comparison of 10 selected OECD countries (continued)

Country	Definition and inclusions in Report	Coverage		Classification
		Types of taxes	Levels of Government	
United Kingdom	All tax reliefs are included according to three categories: structural relief; non-structural reliefs; and reliefs on the borderline.	Income tax; capital gains tax; inheritance tax; stamp duty; national insurance contributions; and VAT.	Central Government	By ‘tax expenditures’, ‘structural relief’ or ‘relief’ with tax expenditures and structural components under each tax if possible.
United States	A tax expenditure is a preferential exception to the baseline provisions of the tax structure. Report includes all tax expenditures according to the definition. Baselines include normal tax baseline and reference law baseline.	Individual and corporate income taxes; estate and gift taxes; and social security contribution.	Federal Government	By budgetary functional category.

Source: Brixi, H, Valenduc, C and Li Swift, Z, 2003, pp 13-15.

14.4 References

ABS, 2005, *Australian System of Government Finance Statistics — Concepts, Sources and Methods*, cat. no. 5514.0, Australian Bureau of Statistics, Canberra.

Brixi, H, Valenduc, C and Li Swift, Z, 2003, *Tax Expenditures — Shedding Light on Government Spending through the Tax System. Lessons from Developed and Transition Economies*, The World Bank.

Treasury, 2005, *2005 Tax Expenditures Statement*, Treasury, Canberra.

Appendix A:

Treasurer's press release

APPENDIX A: TREASURER'S PRESS RELEASE

TREASURER

www.treasurer.gov.au

NO.008

INTERNATIONALLY BENCHMARKING THE AUSTRALIAN TAX SYSTEM

It is important that Australia build its competitiveness in all areas of policy. I have therefore asked Mr Richard (Dick) Warburton and Mr Peter Hendy to lead a study examining how Australia's tax system compares with other developed economies.

This will involve a comparison of overall taxation levels and rates and coverage of the indirect tax, income tax and company tax systems.

The aim of the study is to provide a public document that compares Australian taxes to those in other countries. This will identify those areas where Australia leads comparable countries and those areas where it lags. It will enable a focus on the most important areas.

The study will cover taxes collected at national, state and local government levels. This is OECD standard practice for international tax comparisons.

Personal, business, indirect, property, transaction and superannuation taxes will be included.

Mr Warburton has been Chairman of the Board of Taxation since its inception in September 2000. He is currently Chairman of Caltex Australia Ltd and holds several other directorships. He is also a former Board member of the Reserve Bank of Australia and a past National President of the Australian Institute of Company Directors.

Mr Peter Hendy took up his position as the Chief Executive of ACCI on 3 June 2002. Mr Hendy is also a board director of Standards Australia, the International Chamber of Commerce (Australia), the Australian Institute of International Affairs (President ACT Branch), the Australian Made Campaign Limited and of the National Business Action Fund. He is a governor of the National Institute of Labour Studies. He is Chairman of the Joint Policy Committee of the Confederation of Asia-Pacific Chambers of Commerce and Industry. Mr Hendy has a strong background in public administration and policy development at Federal and State levels, for both Liberal and Labor Governments. He was Chief of Staff to

the Minister for Defence and Chief of Staff to the Ministers for Workplace Relations and Education.

The study will be supported by a small secretariat in Treasury.

I have asked Mr Warburton and Mr Hendy to report to me by 3 April 2006.

The terms of reference for the study are attached. Further information on the study can be obtained from the website at http://comparativetaxation.treasury.gov.au or by contacting the study secretariat on (02) 6263 3033.

MELBOURNE

26 February 2006

Appendix B:

List of submissions

APPENDIX B: LIST OF SUBMISSIONS

Although formal submissions were not called for under the terms of reference, the option was provided to make submissions to the study. The following individuals and organisations did so.

International Comparison of Australia's Taxes — List of submissions	
Aitken, J N	Foot, Rosemary
Association of Superannuation Funds of Australia	Frost, Tony
Australian Bankers' Association	Game Developers' Association of Australia
Australian Catholic Commission for Employment Relations	Glover, Peter
Australian Council of Public Sector Retiree Organisations	Gnieslaw, Isaac
Australian Friendly Societies Association	Gore, Steve
Australian Industry Group	Greene, Coleen
Australian Information Industry Association	Greenfield, E J
Australian Petroleum Production & Exploration Association	Gundagai District Council, NSW Farmers Association
Australian Stock Exchange Ltd	Harris, Alex
Australians for Tax Justice	Heaton, Bob
Ayles, Raymond	Hemlof, Loris Erik Kent
Bain, John M	Hodgkin, Mark
Barter Jobs Australia	Hudson, Paul
Barwon Darling Alliance	Institute of Chartered Accountants in Australia
Berry, Trevor and Rose-Marie	Insurance Australia Group
Bhagat, Ranjan	Insurance Council of Australia
Bligh, Anna, MP (Treasurer, Queensland)	Investment and Financial Services Association
Boyapati, Dr E	Kanost, Harold S
Brown, H McC E	Kendall, Kathryn
Brumby, John, MP (Treasurer, Victoria)	Kitchen, Leigh
Cadman, Alan, MP	Kotsopoulos, John
Campbell, Roderick C	Lee, Tim
Carter, John	Lienert, David
Catholic Welfare Australia	Local Government Association of New South Wales
Central West Regional Organisation of Councils	Lorme, Dr Kenneth
Collishaw, R W	Lowry, Martin
Committee for Economic Development of Australia	Manning, Brendan
Communication Research Institute of Australia	Manusa, Jane
Cookson, Morris W	Markham, Dr Michelle
Currie, Judith	Matters, Russel
Daniel, Len	McRae, Kingsley
Dodem, Peter	Miller, Craig
Eardley, A	Moore, Charles
Ehmann, Hans	Morrison, Darrell
Endeavour Forum	Murray, Andrew (Senator)
Ernst & Young	National Council on Intellectual Disability
Fielding, Steve (Senator)	National Institute of Accountants
Finaghty, Jim	National Rural Health Alliance
Fittler, Tony	National Tourism Investment Strategy

International Comparison of Australia's Taxes — List of submissions (continued)	
Ogden, Dr John	Stranger, Elaine
Pasas, Marios	Swaffield, Ian
Property Council of Australia	Tanner, Richard
Prosser, Geoff, MP	Tierney, Alan T
Public Transport Users Association	Tran, Brandon
Queensland Remote Area Planning and Development Board	Victorian Innovation Economy Advisory Board
Richards, D P	Wadsley, Alex
Royston, David	Warren, Dr Neil
Seaton, Kate	Waters, John
Sellars-Jones, G R	Watson, Donald C
Seventh-Day Adventist Church	Watts, Kevin
Shires Association of New South Wales	Westfield Group
Sless, Professor David	Wiegel, Dr Klaus
Smith, Duncan	Williamson, Professor Ian and Jude Wallace
Smith, Grahame	Wilson, Dave
Stevenson, Sheryl	Wilson, R R M
Stower, John	

Appendix C:

The OECD classification of taxes

APPENDIX C: THE OECD CLASSIFICATION OF TAXES

1000 Taxes on income, profits and capital gains	2000 Social security contributions	3000 Taxes on payroll and workforce	4000 Taxes on property	5000 Taxes on goods and services		6000 Other taxes
1100 Taxes on income, profits and capital gains of individuals **1110** On income and profits **1120** On capital gains **1200** Corporate taxes on income, profits and capital gains **1210** On income and profits **1220** On capital gains **1300** Unallocable as between 1100 and 1200	**2100** Employees **2110** On a payroll basis **2120** On an income tax basis **2200** Employers **2210** On a payroll basis **2220** On an income tax basis **2300** Self-employed or non-employed **2310** On a payroll basis **2320** On an income tax basis **2400** Unallocable as between 2100, 2200 and 2300 **2410** On a payroll basis **2420** On an income tax basis		**4100** Recurrent taxes on immovable property **4110** Households **4120** Other **4200** Recurrent taxes on net wealth **4210** Individual **4220** Corporate **4300** Estate, inheritance and gift taxes **4310** Estate and inheritance taxes **4320** Gift taxes **4400** Taxes on financial and capital transactions **4500** Other non-recurrent taxes on property **4510** On net wealth **4520** Other non-recurrent taxes **4600** Other recurrent taxes on property	**5100** Taxes on production, sale, transfer, leasing and delivery of goods and rendering of services **5110** General taxes **5111** Value added taxes **5112** Sales taxes **5113** Other general taxes on goods and services **5120** Taxes on specific goods and services **5121** Excises **5122** Profits of fiscal monopolies **5123** Customs and import duties **5124** Taxes on exports **5125** Taxes on investment goods **5126** Taxes on specific services **5127** Other taxes on international trade and transactions	**5128** Other taxes on specific goods and services **5130** Unallocable as between 5110 and 5120 **5200** Taxes on use of goods, or on permission to use goods or perform activities **5210** Recurrent taxes **5211** Paid by households in respect of motor vehicles **5212** Paid by others in respect of motor vehicles **5213** Other recurrent taxes **5220** Non-recurrent taxes **5300** Unallocable as between 5100 and 5200	**6100** Paid solely by business **6200** Paid by other than business or unidentifiable

Source: OECD *Revenue Statistics*, 2005.