Executive Summary

Contents

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.

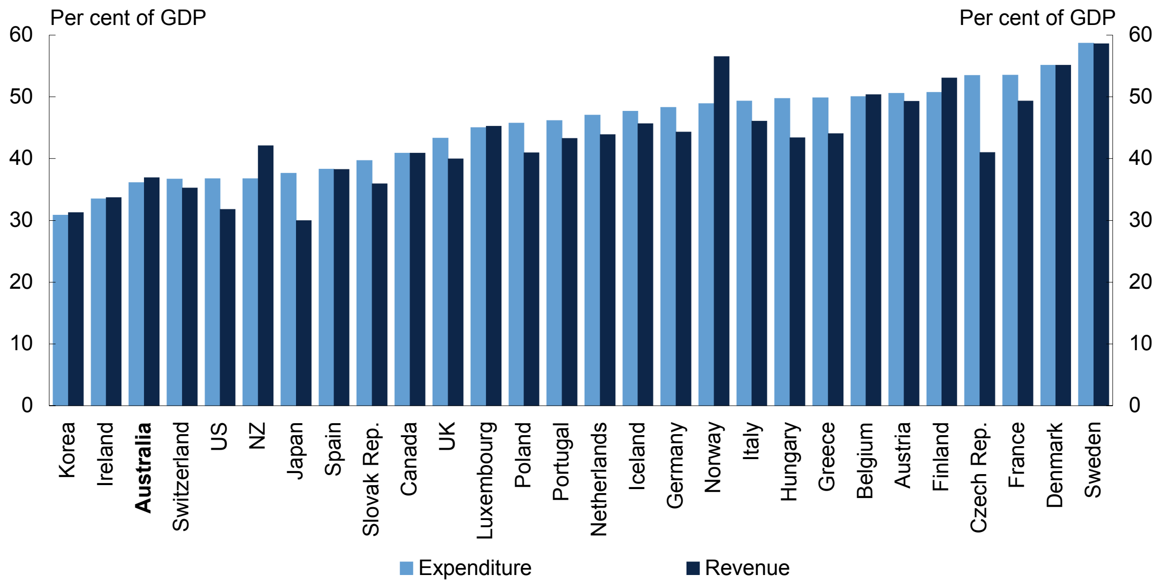
Australia's reliance on property and transaction taxes, which are virtually all levied by State, Territory and local governments, is relatively high compared with the OECD-30. Australia's reliance on property and transaction taxes is more in line with the OECD-10, despite having the highest tax burden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

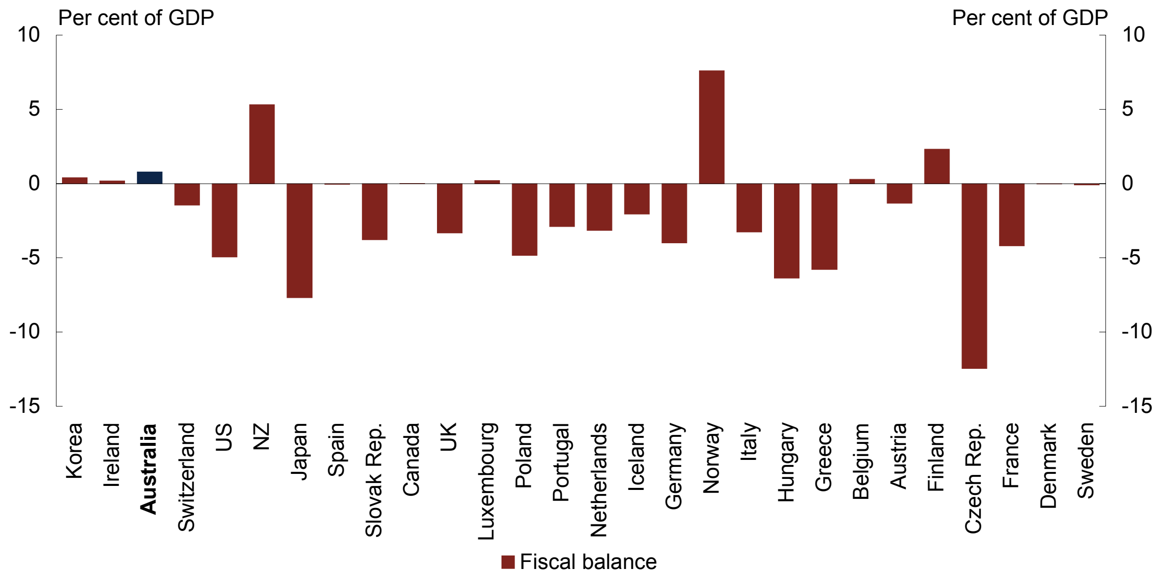
THE ROLE OF TAXES IN PUBLIC FINANCE

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.

Chart 1: Fiscal position of OECD-30
Expenditure, revenue and fiscal balance as a proportion of GDP, 2003





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

A STATISTICAL OVERVIEW

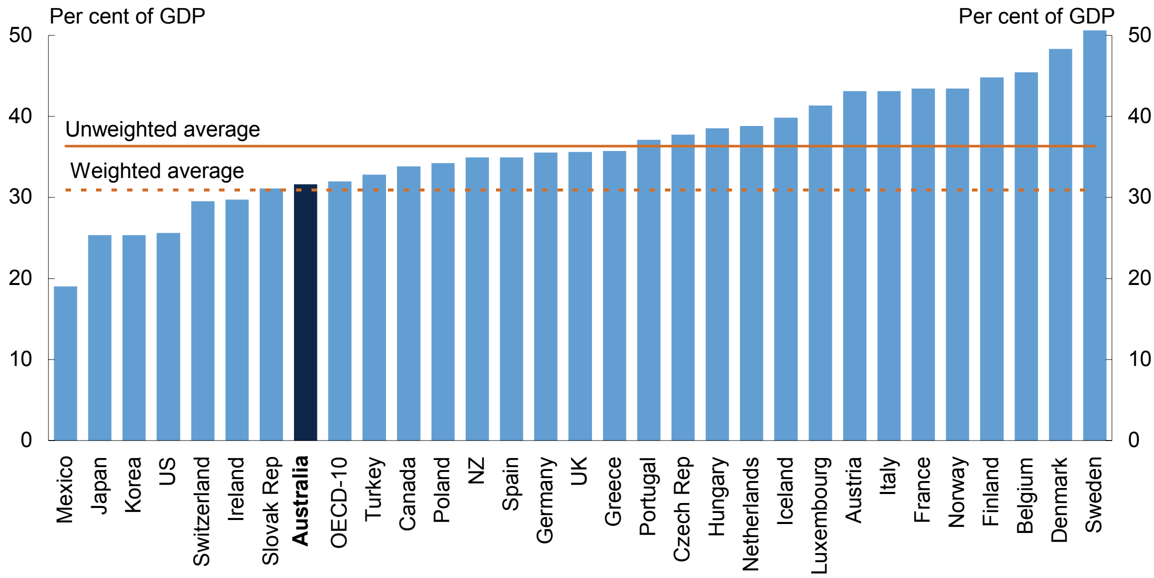
Australia has a low overall tax burden compared with the OECD-30, both currently and historically. Australia's tax mix is in line with OECD-30 countries, although there are some distinguishing features.

- 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

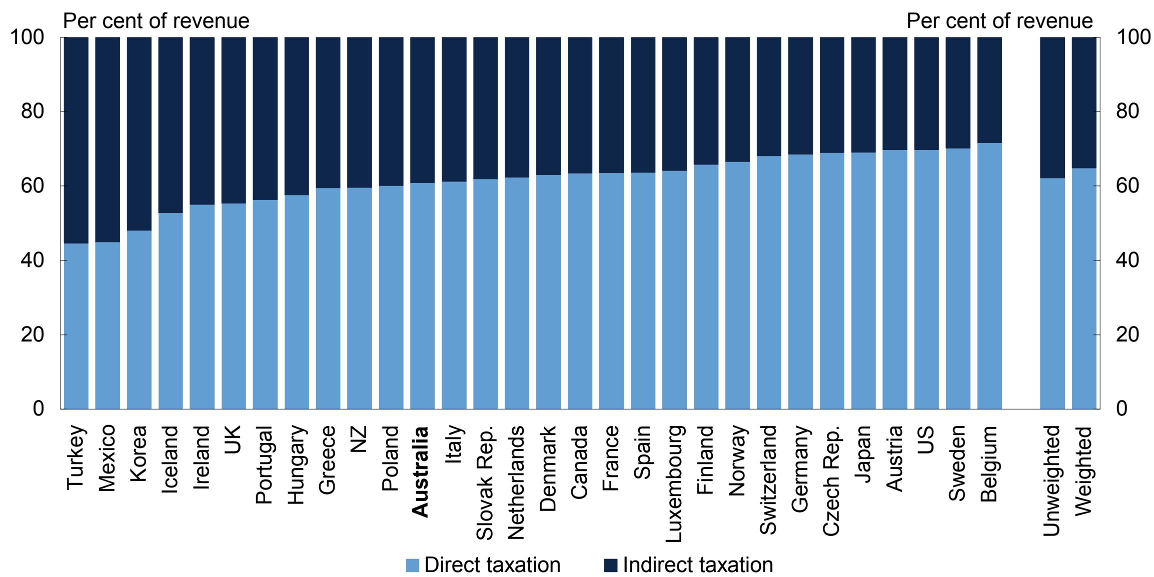


Source: OECD *Revenue Statistics*, 2005.

- 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.

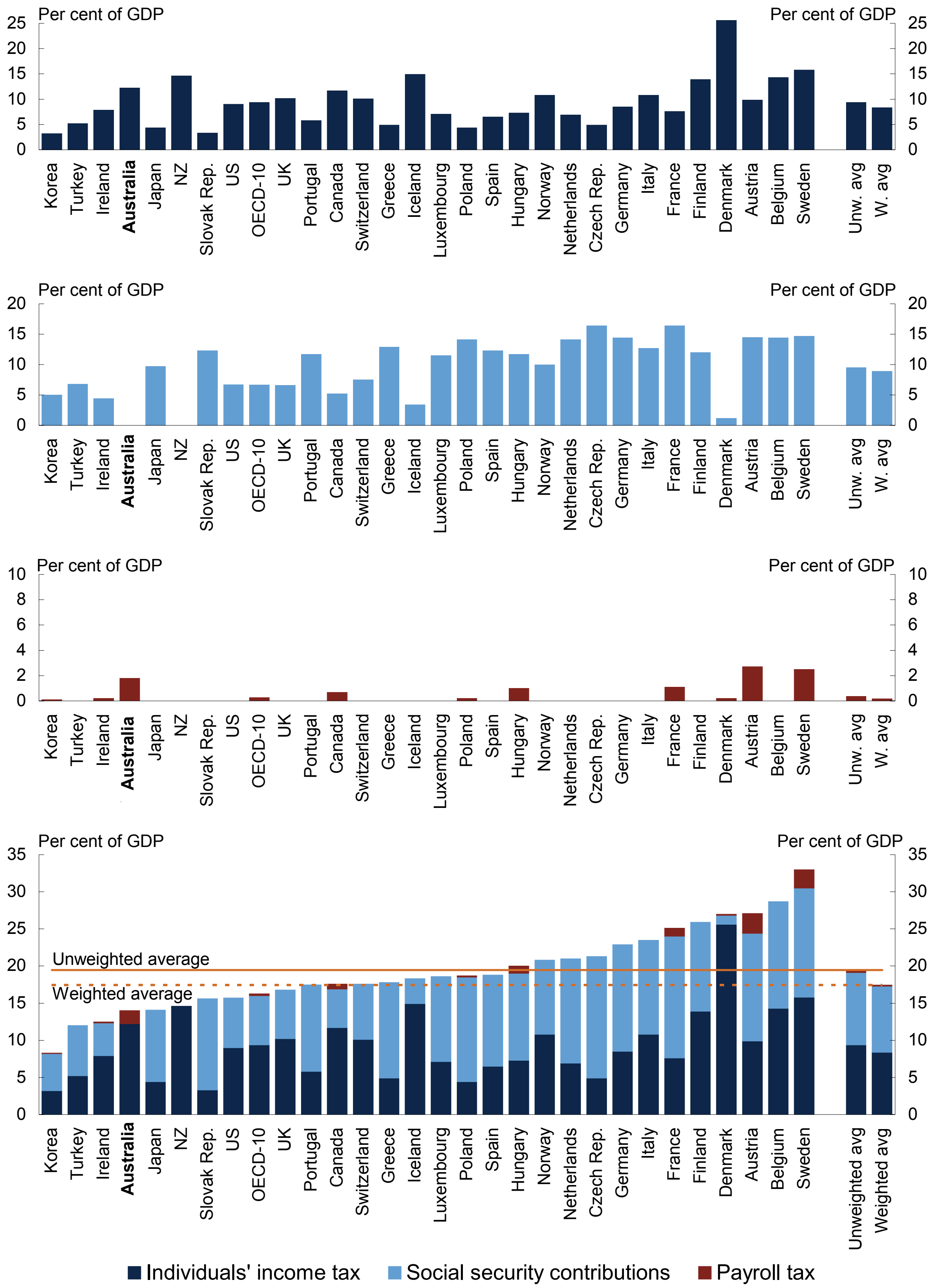
WAGE AND SALARY TAXATION

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).

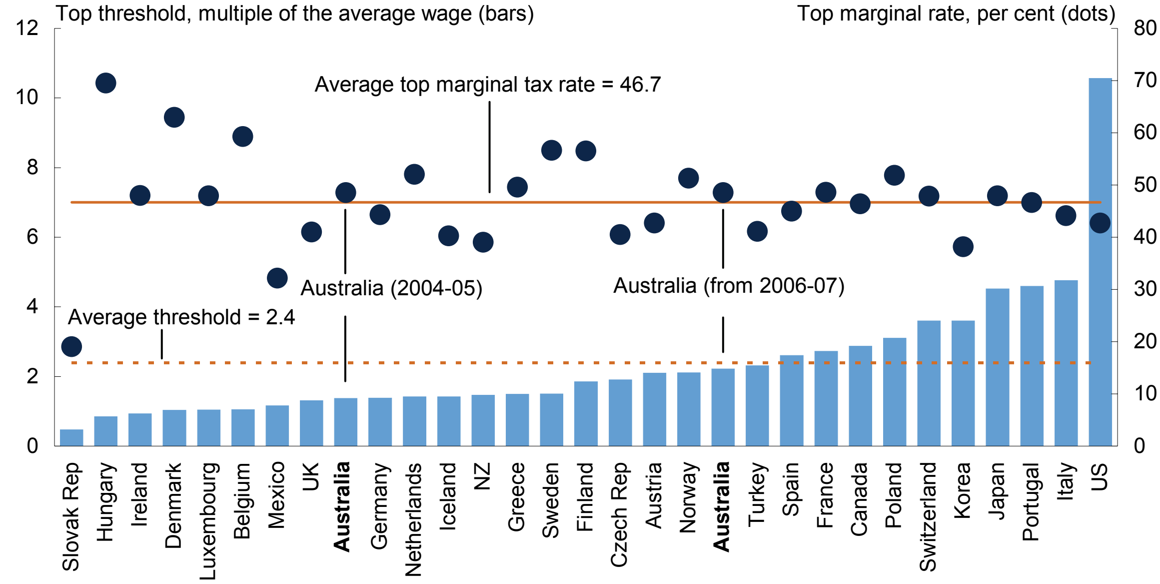
Chart 4: Components of direct taxation in respect of individuals and payrolls

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.

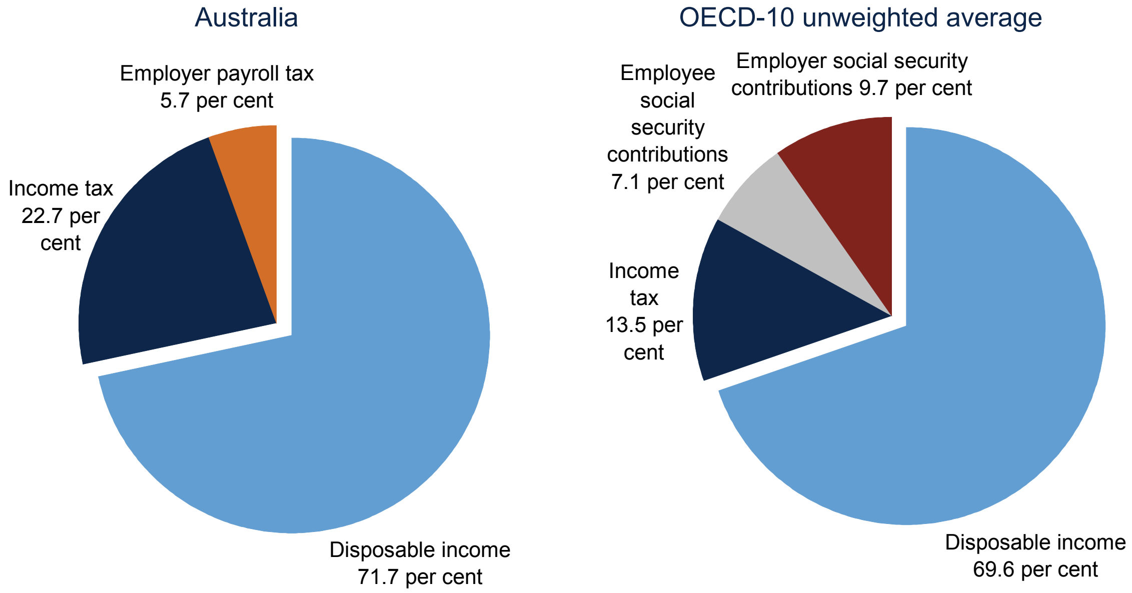
- As a result of Australia's tightly targeted welfare system, effective marginal tax rates are generally higher than those in the other OECD-10 countries.

- 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.

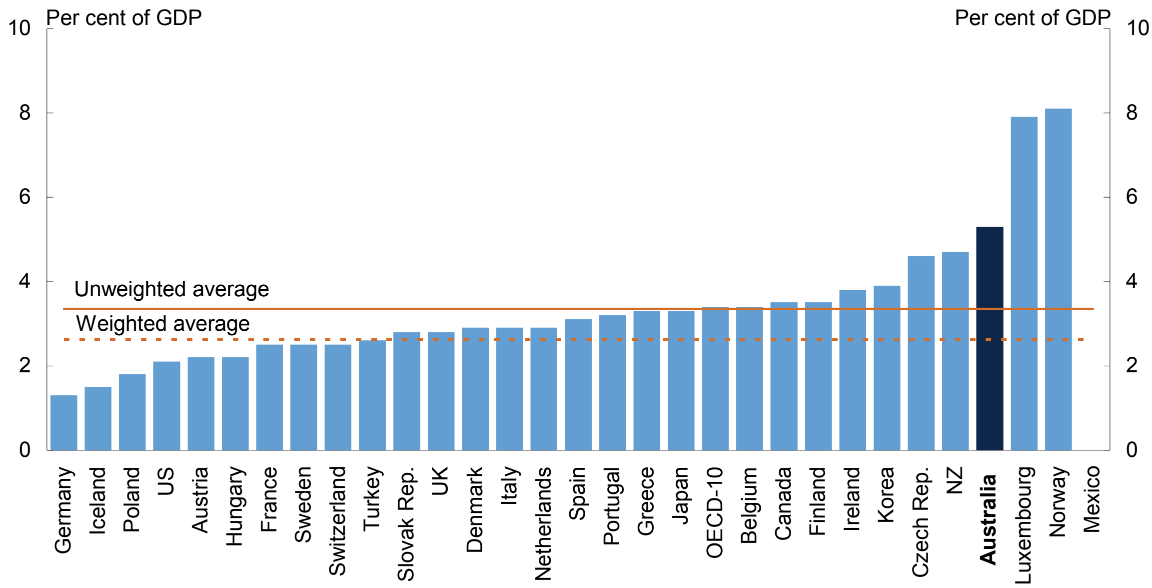
- Australia has the equal lowest value of depreciation allowances of the OECD-10 for plant and equipment.

- 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.

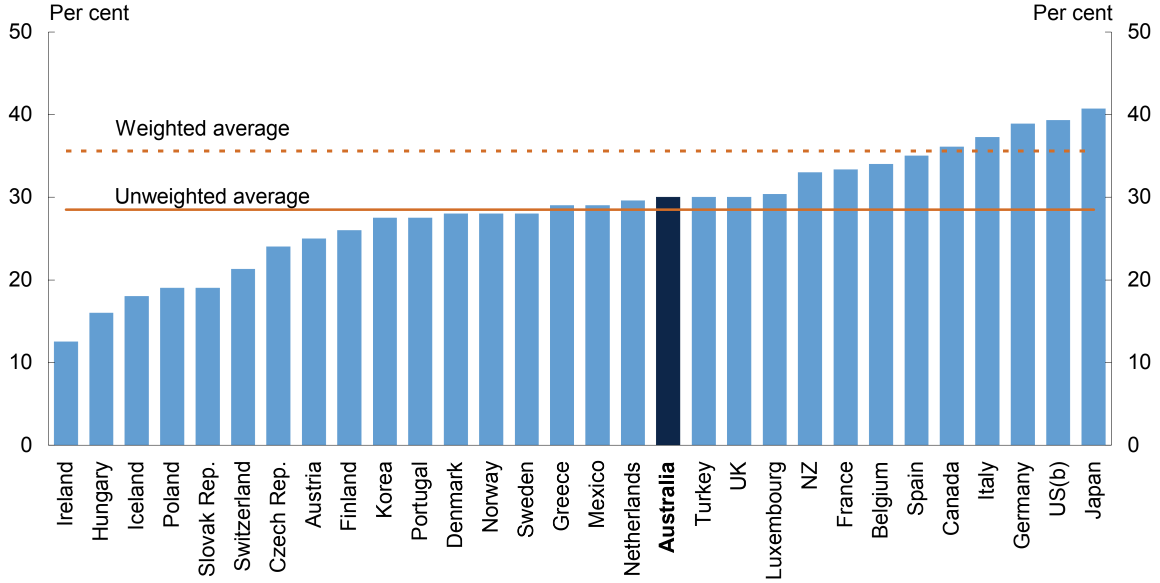
Chart 7: Direct taxation in respect of companies[(a)]

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 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.

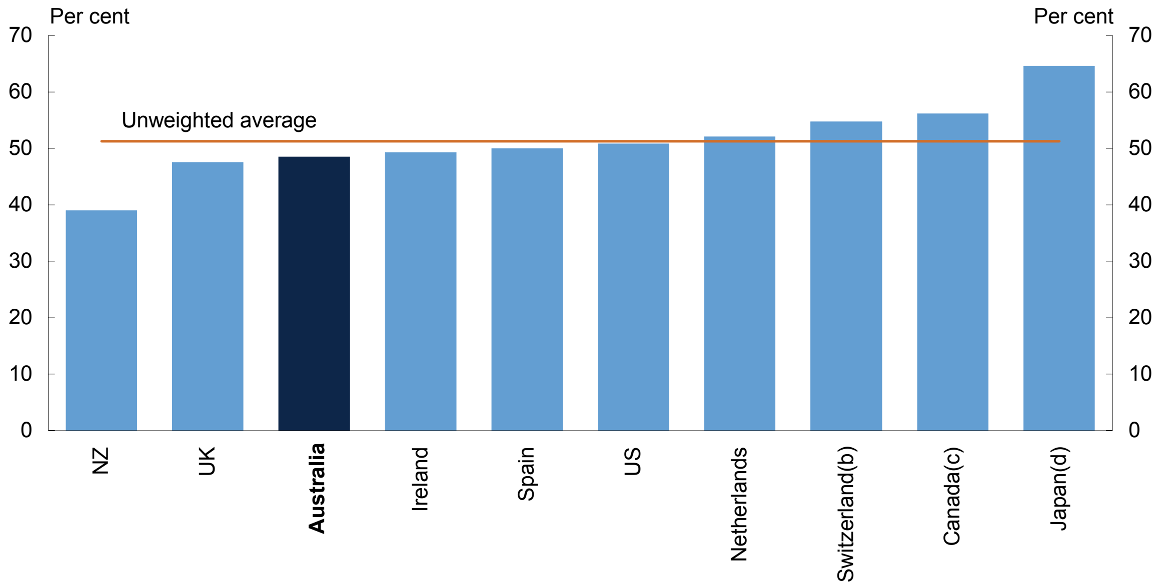
- All of the OECD-10 countries, including Australia, provide some form of concessional treatment for capital gains.

- 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).

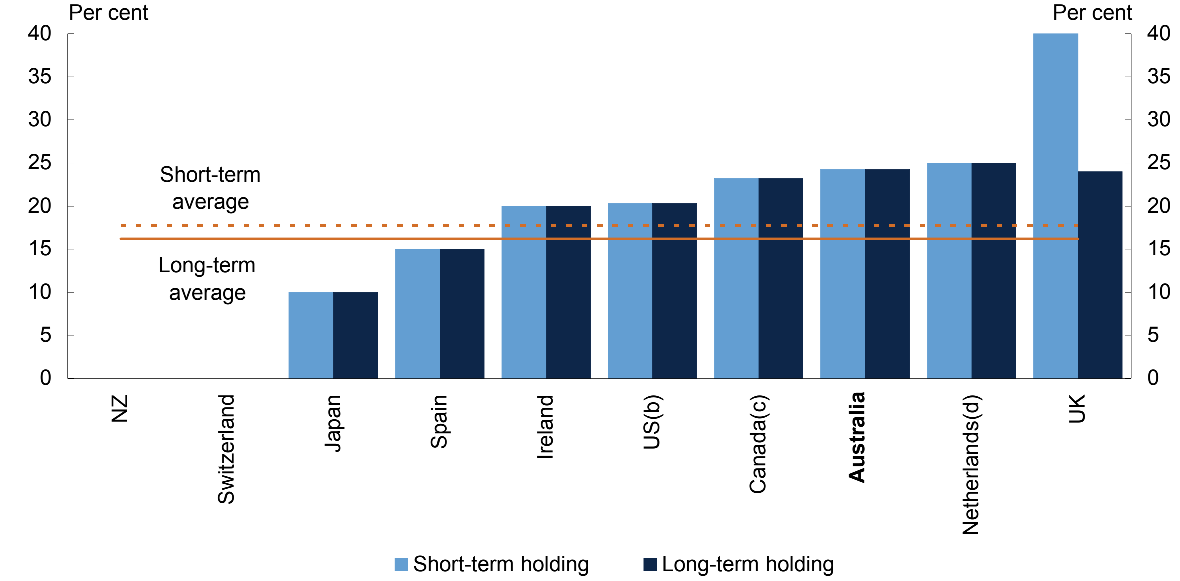
- Most countries in the OECD-10 have a lower tax rate on interest income compared with the all-in tax rate on wage and salary income. In many cases, this is because social security contributions do not apply to capital income.

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



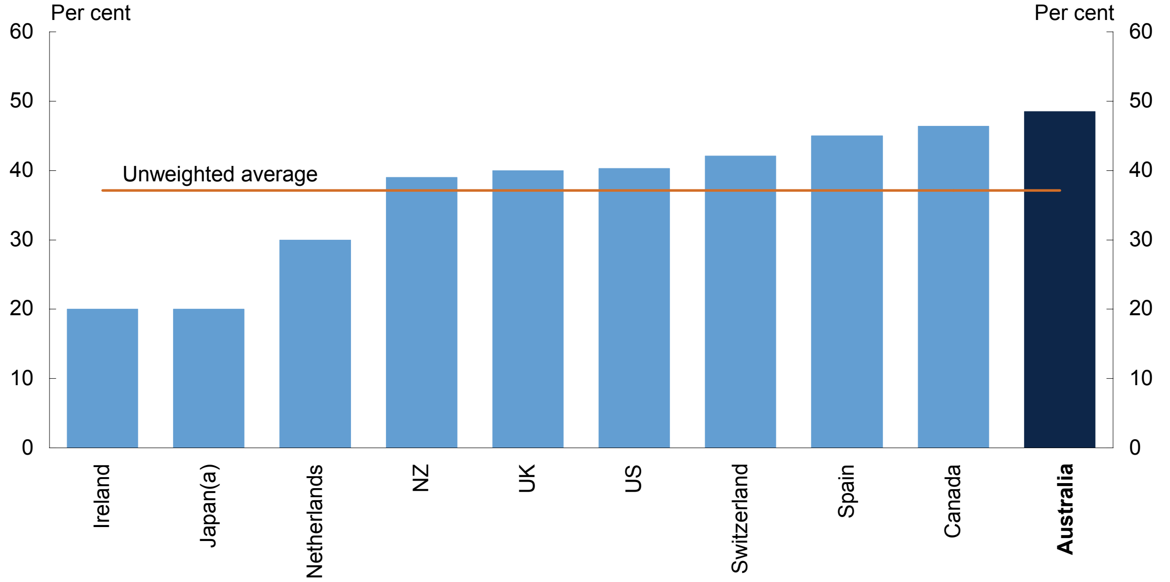
(a) Overall statutory tax rates on distributions of domestic source income to a resident individual shareholder, incorporating corporate income tax, personal income tax and any type of shareholder relief.
(b) The corporate income tax rate includes the church tax, while the personal income tax rate excludes 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.

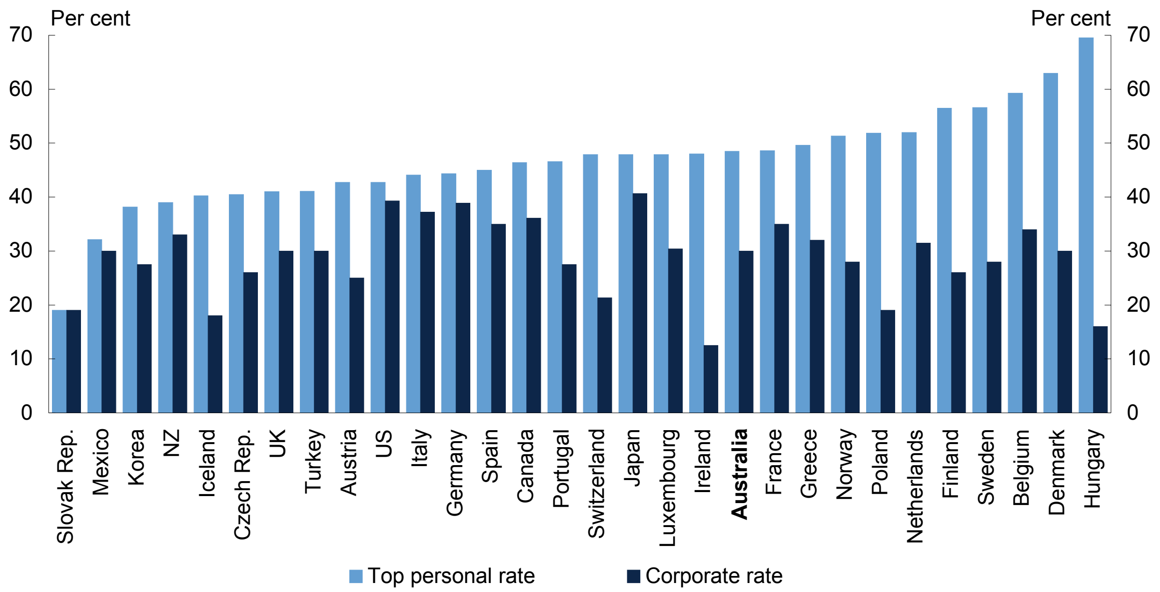
- Of the 30 OECD countries, only one, the Slovak Republic, has aligned its top marginal personal tax rate and full statutory corporate tax rate.

- 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.

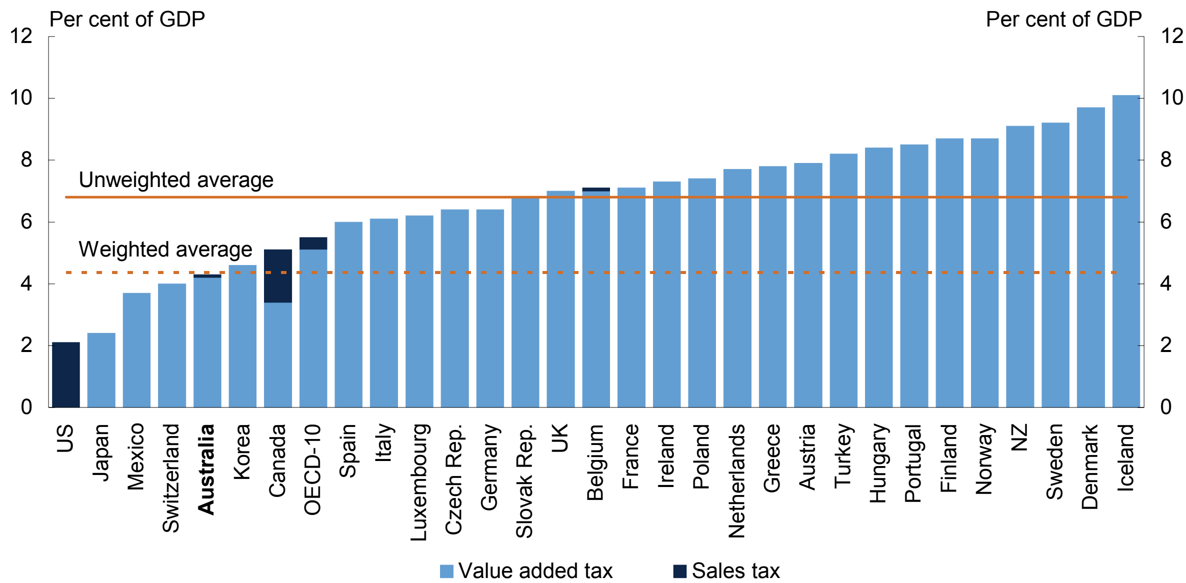
- When compared with the OECD-10, Australia is placed about mid-range for the generosity of its contribution limitations and provides above-average concessions in terms of the availability and taxation treatment of lump sum payments.

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.

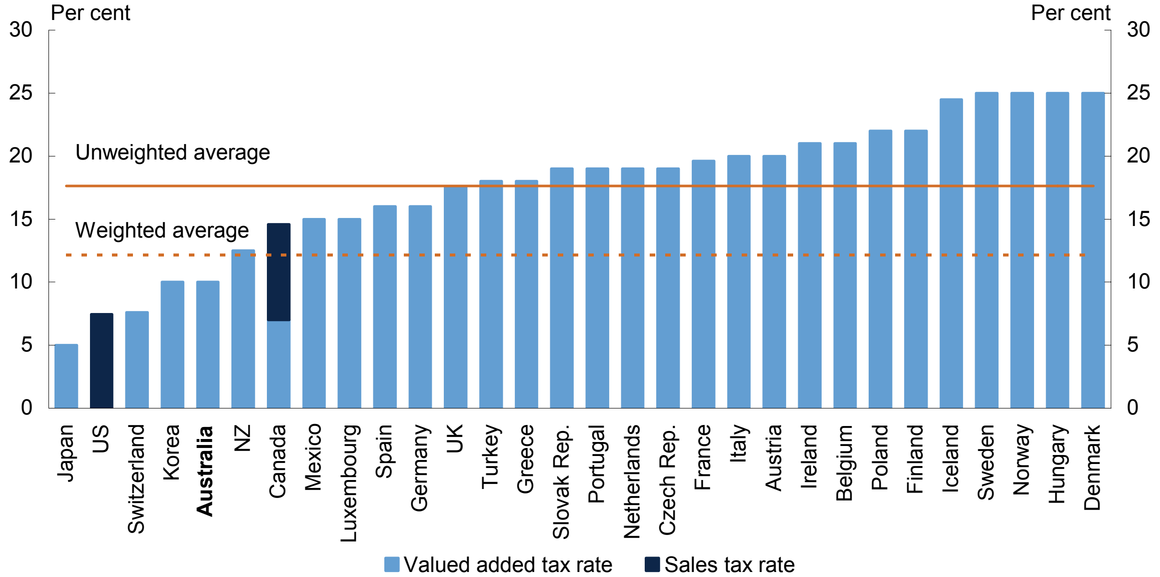
- Australia's reliance on goods and services taxes is the fifth lowest in the OECD-10, at 9.4 per cent of GDP, only marginally higher than the OECD-10 average (9.2 per cent).
- Australia's indirect tax mix has a lower reliance on value added and sales taxes (4.3 per cent of GDP). Australia's tax burden 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



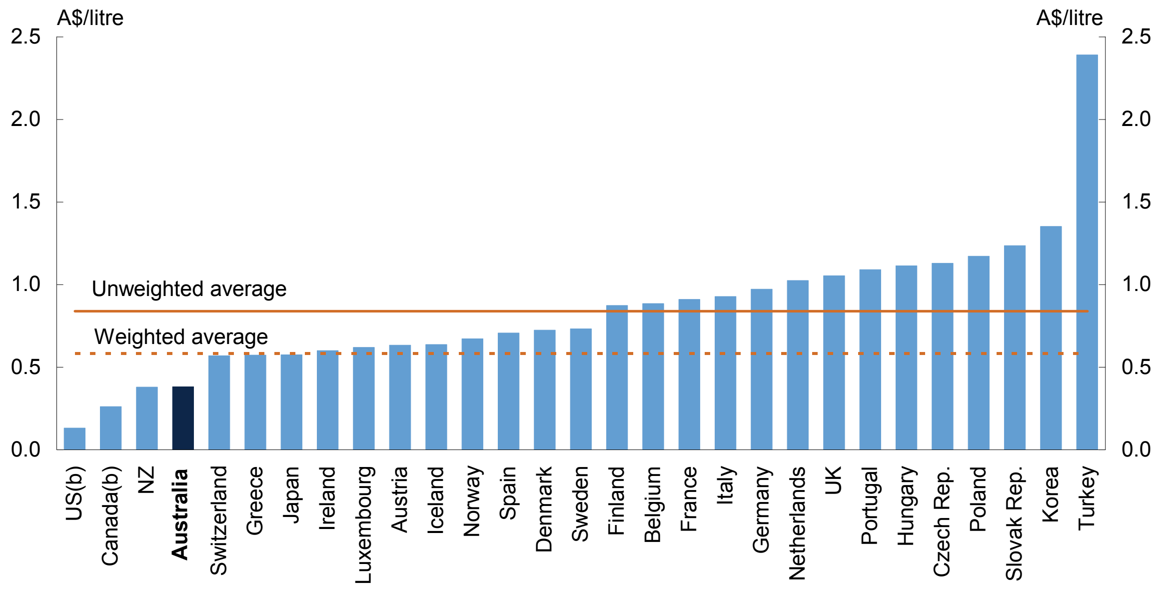
Source: OECD *Revenue Statistics*, 2005.

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.

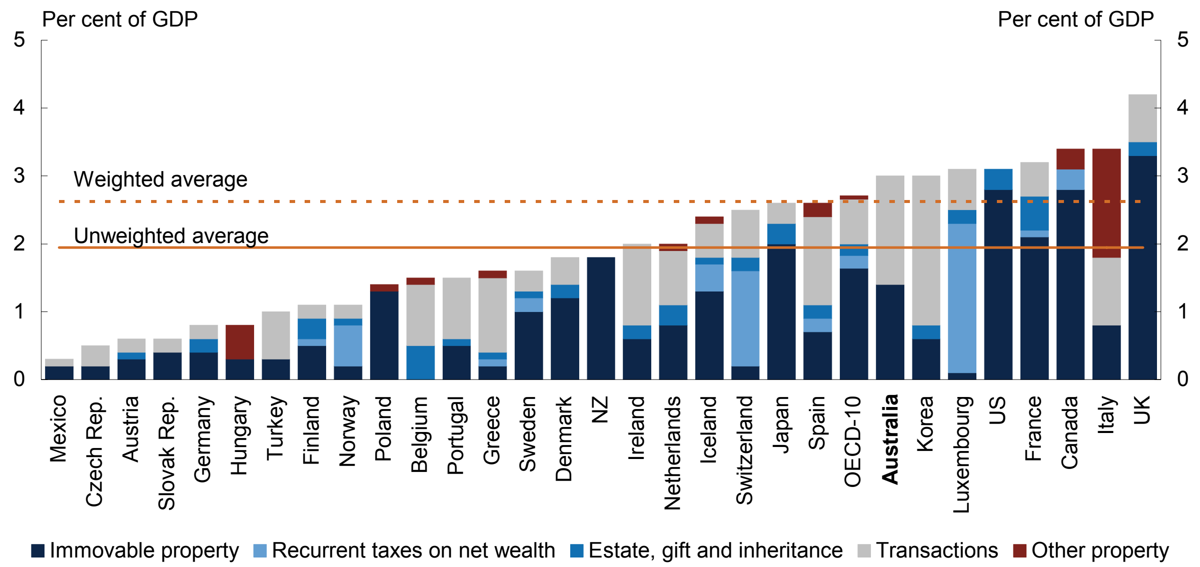
PROPERTY AND TRANSACTION TAXATION

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.