Snapshots Of Australian Corporate Tax History

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Outline of presentation

- 5 snapshots: 1918; 1946; 1953; 1990 and 2017
- Outline of basic features of corporate – shareholder tax system in each period
- Brief analysis of key effects of rules in tax policy and anticipated behavioural response terms
- Presentation of effective tax rates of distributions in each period
- Conclusions

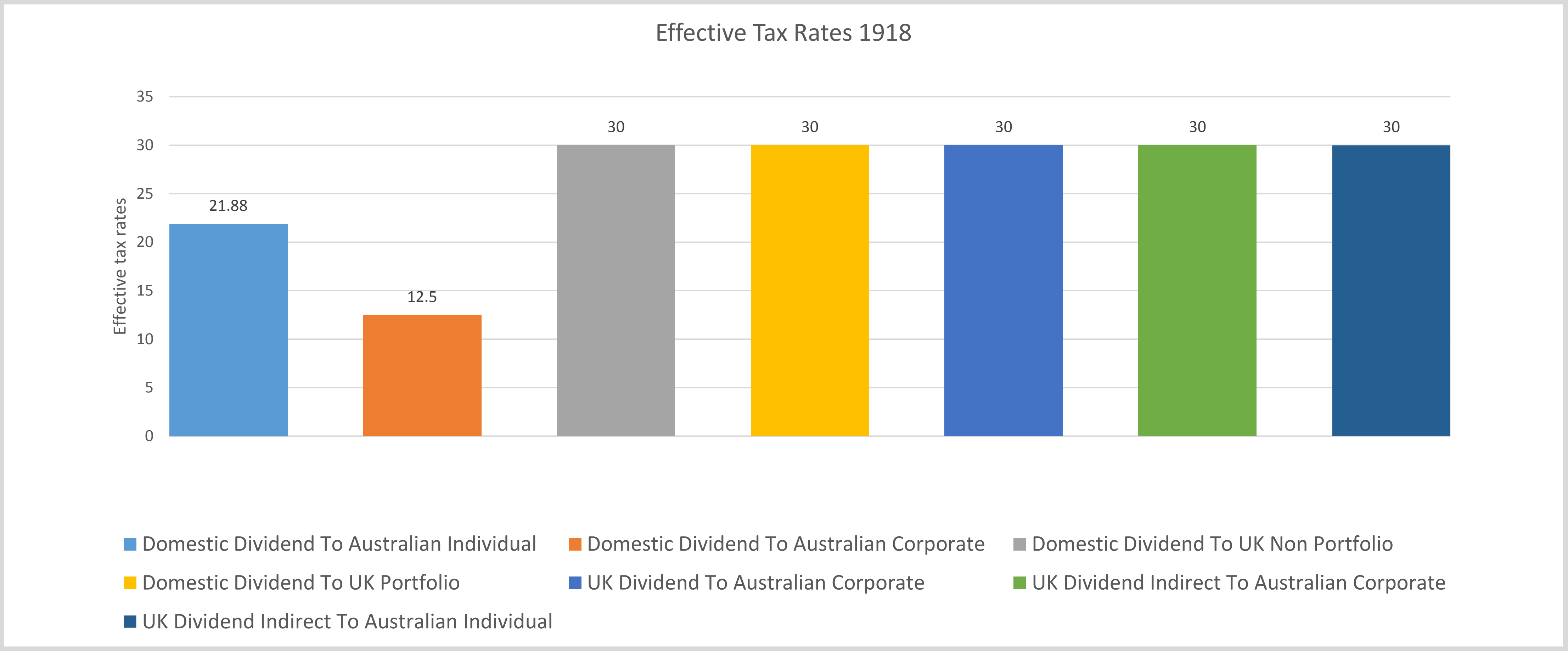
1918

- Corporate rate 12.5%
- Top marginal rate on income from property 25%
- Only taxed Australian source income – redistribution of foreign source income exempt
- No concept of resident all taxpayers taxed on an assessment basis
    - Some withholding type obligations on payments to ‘absentees’
- No taxation of capital gains but dividends funded from capital gains assessable to shareholder
- Dividend deduction system with imputation for distributions of taxed retained income
- Inter-corporate dividend rebate – applied to Australian and foreign incorporated companies
- Shareholder allocation system where excessive retention
- No tax treaties

1918

- Capital import neutrality
- Non discrimination
- Neutral between debt and equity funding
- Some super-integration where retained and taxed income distributed
- Capital gains preferences washed out on distribution
- Share sales advantaged over distributions

Effective Tax Rates 1918



1946 – pre Treaty Position

- Corporate rate 30% - also lesser of Super Tax at 5% or War-time (Company) Tax (only corporate rate of 30% used in calculating effective rates)
- Top marginal rate on income from property + social services contribution 83.33%
- Classical corporate-shareholder tax system
- Nominal worldwide taxation of residents but broad exemption under *ITAA* 1936 s23q if income subject to foreign tax
- Inter-corporate dividend rebate under *ITAA* 1936 s46 only available to resident companies
- s72A deduction for individuals for DWT – later replaced with a credit
- No withholding taxes but provisional tax system based on prior year's income – dividends paid to non-resident companies taxed at 35%
- Dominion Income Tax Relief with the UK meant UK credited up to 25% (half UK standard rate)
- Capital gains not taxed by preference washed out on distribution
- Undistributed profits tax on both private and non-private companies

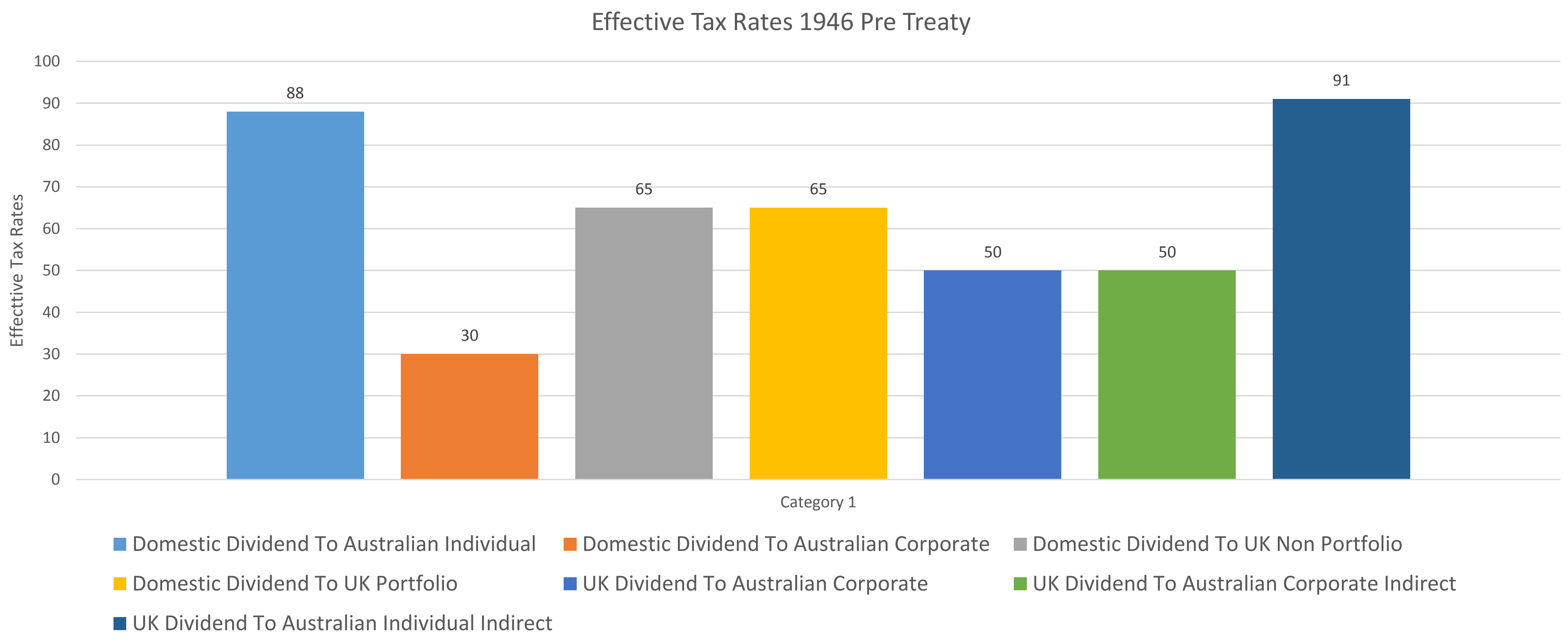
1946 Post Treaty Position

- Zero tax on dividends to 100% parent (branch equivalent rationale)
- 50% reduction in source tax on other dividends
- Full foreign tax credit for withholding and underlying corporate tax irrespective of level of shareholding – Australian credit provisions did not apply to exempt income

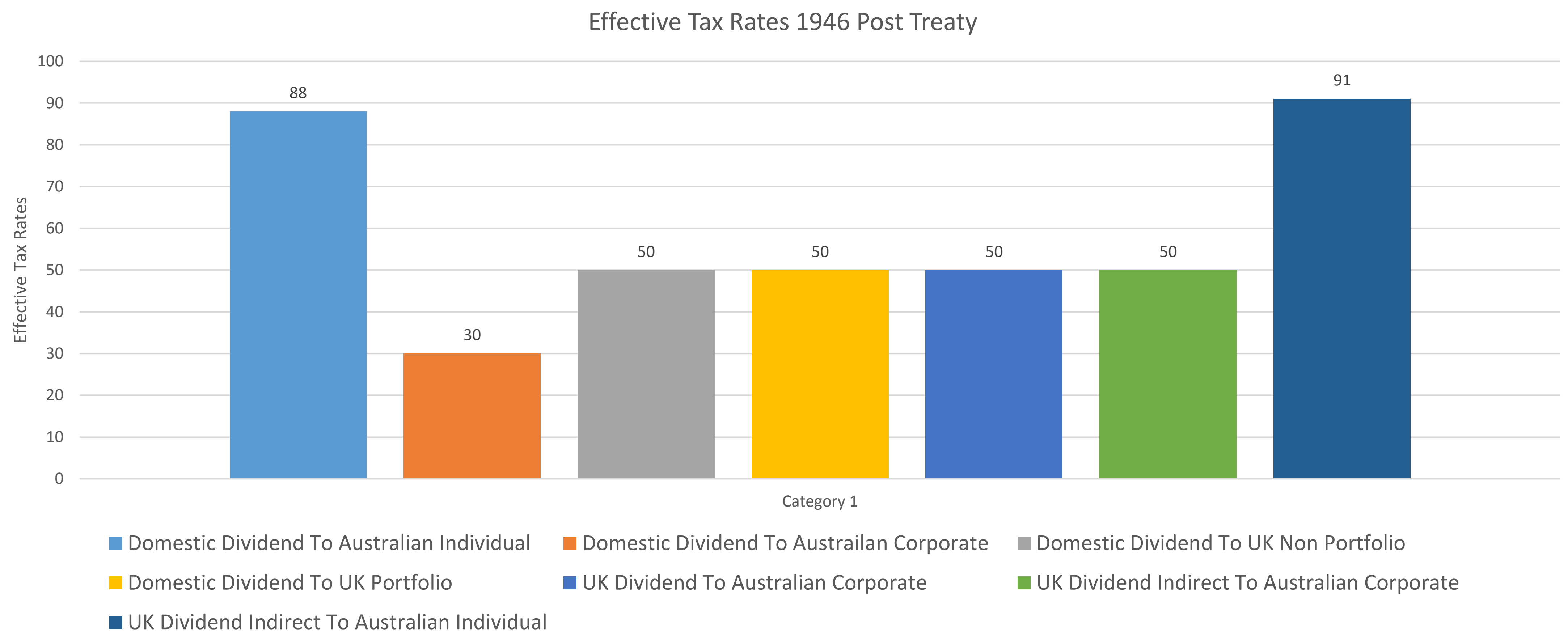
1946 Pre Treaty and Effect of Treaty

- Non discrimination for individuals
- Discrimination against non-resident corporates (no s46 rebate)
- Dominion Income Tax Relief produced result somewhere between CIN and NN. High rates of tax here main driving force for treaty
- At Australian corporate level result of UK dividend = CIN
- At underlying Australian individual shareholder level result of UK dividend = NN.
- Clear debt bias for funding Australian companies
- Treaty reduced source country tax provided full credit with consequent lowering of effective rates
- CEN for UK shareholder on receipt of Australian dividend

Effective Rates 1946 Pre Treaty



Effective Rates Post 1946 Treaty



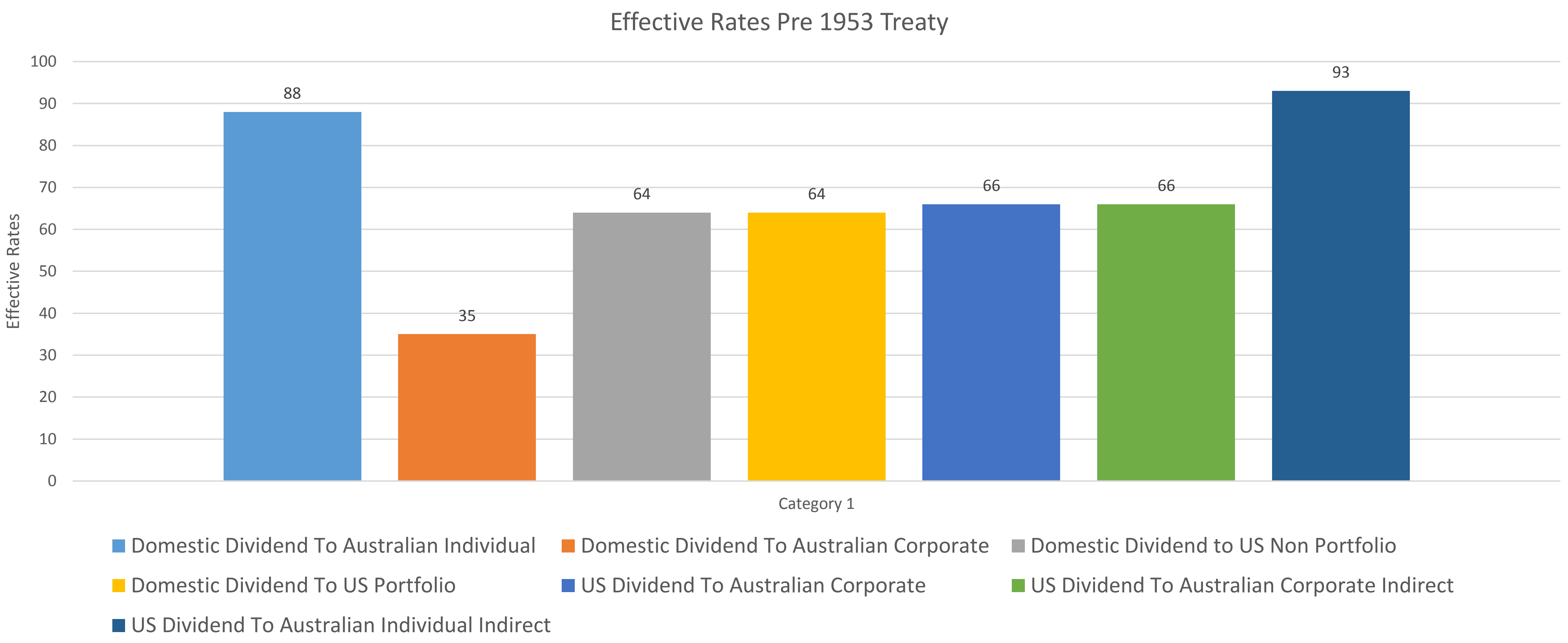
1953 US - Australia

- Corporate rate for non private companies 35% + 10% additional levy
- Dividends paid to US companies taxed at 35%
- Top marginal rate for individuals 75% additional tax payable on income from property – for calculation purposes additional rate of 3.63% used making a top rate of 78.63%
- No treaty with the US
- US gave full FTC for non-portfolio investment and direct FTC for portfolio investment
- US corporates had excess foreign tax credits on direct investment into Australia – main driving force for treaty
- Undistributed profits tax only on private companies
- Treaty uniformly reduced source country tax on dividends to 15% - standard policy under 2001

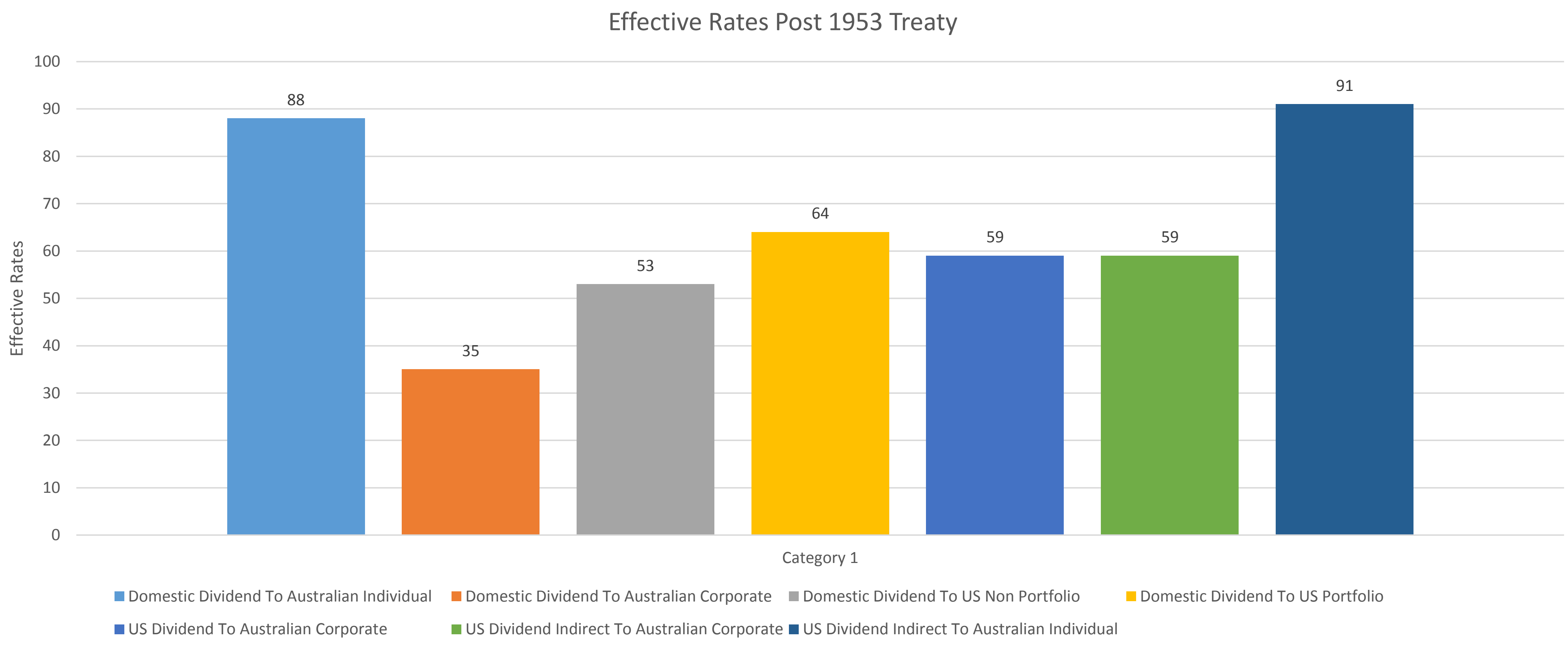
1953 US - Australia

- Discrimination against US corporates (no s46 rebate)
- Pre treaty – excess credit produced CIN equivalent result for US corporates receiving Australian dividends
- At Australian corporate level result of US dividend = CIN
- At Australian underlying individual shareholder receipt of US dividend = NN
- Debt bias for funding Australian companies
- Treaty lowered source country tax and consequently lowered effective rates
- Post treaty – CEN for US corporates receiving Australian dividends

Effective Rates Pre 1953 Treaty



EFFECTIVE RATES POST 1953 TREATY



1990

- From 30 Jun 1990 corporate rate was 39%
- Top marginal rate + medicare levy was 48.25%
- Super funds were taxed at 15% on investment earnings
- CGT introduced with effect from 19 September 1985 – applied to non-portfolio shareholdings of non-residents – indexation for inflation system
- Shareholder credit account type imputation system – tracked income minus tax paid – excess credits not refundable – ordering rules effectively meant taxed profits regarded as being distributed first – in inter-corporate context credit limited to franked portion of dividend
- Withholding tax for dividends and interest – standard treaty rate for dividends 15%
- Franked portion of dividend exempt from DWT via s128B(3)(ga) and exempt from tax on assessment via s128D

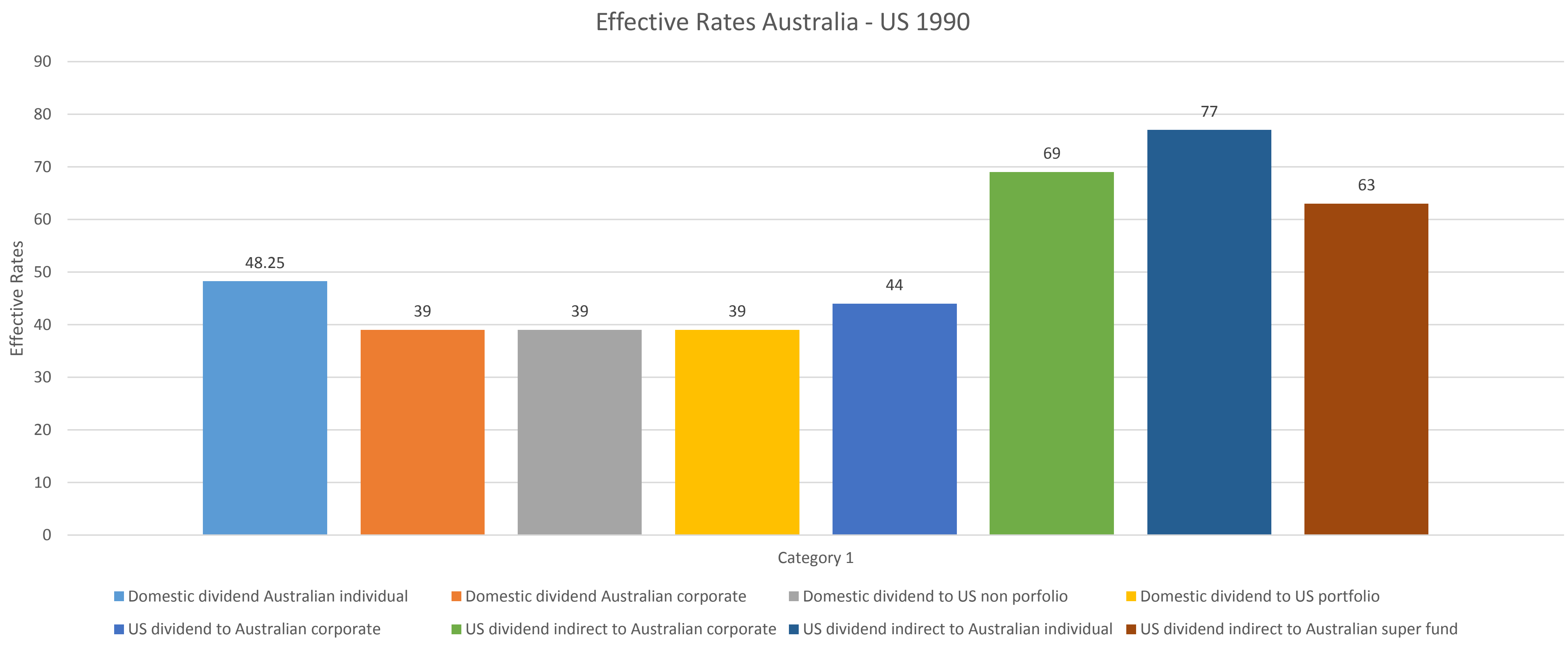
1990 Continued

- Active Foreign Branch Profits and Foreign Non Portfolio dividends from listed countries = exempt
- FTC for other foreign source income – basket system used
- Foreign losses quarantined 1990-91 on a class of income basis
- Thin Cap rules introduced 1987 3:1 debt to equity ratio
- ITAA 1936 Division 13 Transfer Pricing rules had been introduced
- CFC rules introduced 1990 – attribution and active income tests differed for listed and unlisted countries
- ITAA 1936 Part IVA (the 'new' GAAR) had been introduced
- Treaty network had expanded significantly – 1967 UK Treaty a model for many later treaties – 1982 US Treaty most recent US Treaty – Australian treaties slowly moving closer to OECD Model

1990

- Discrimination against both individual and foreign residents by not extending imputation gross up and credit to them – foreign investors likely to seek to reduce Australian corporate tax
- For active business exemptions produced CIN at direct corporate investor level
- Corporate tax preferences washed out on distribution – tendency for them to be retained at corporate level
- For indirect investors interaction with imputation produced NN at underlying shareholder level
- Imputation system produces incentive for Australian controlled companies to pay Australian tax
- Debt bias for domestic investors largely removed but still existed for cross border investors despite Thin Cap rules
- Taxation of active income arising in or diverted to low tax countries could be deferred indefinitely
- Excess credit position for US portfolio and non-portfolio investors

Effective Rates Australia – US 1990



2017

- Corporate rate (for large corporates) 30%
- Top marginal rate + levies 49%
- Imputation system tracking tax paid with fully refundable credits for most residents
- Franked portion of dividend still exempt from DWT and tax on assessment
- Dividends attributable to PE taxed on assessment basis
- Exemption for active foreign branch profits and active non portfolio dividends applied irrespective of where PE or subsidiary was located

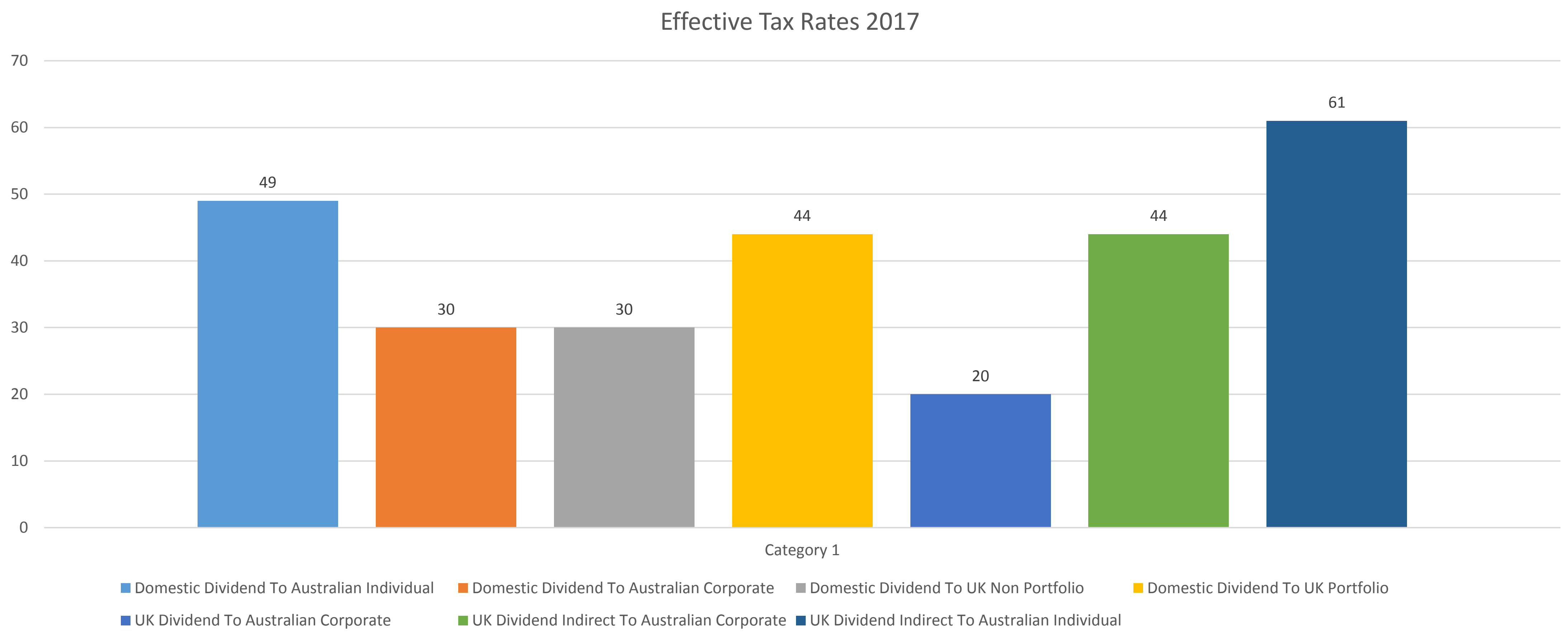
2017 Continued

- CFC rules applied same active income test to listed and unlisted countries but attribution rules differ between them
- New Thin Cap rules
- New Transfer Pricing rules
- MAAL and DPT introduced
- Post 2001 treaty policy for lower withholding rates for 80%+ ownership and other non-portfolio shareholdings
- CGT discounts for individuals, trusts and super funds but not for companies
- Capital gains taxation on shares of non residents limited to shares attributable to an Australian PE and shares in Australian land rich companies

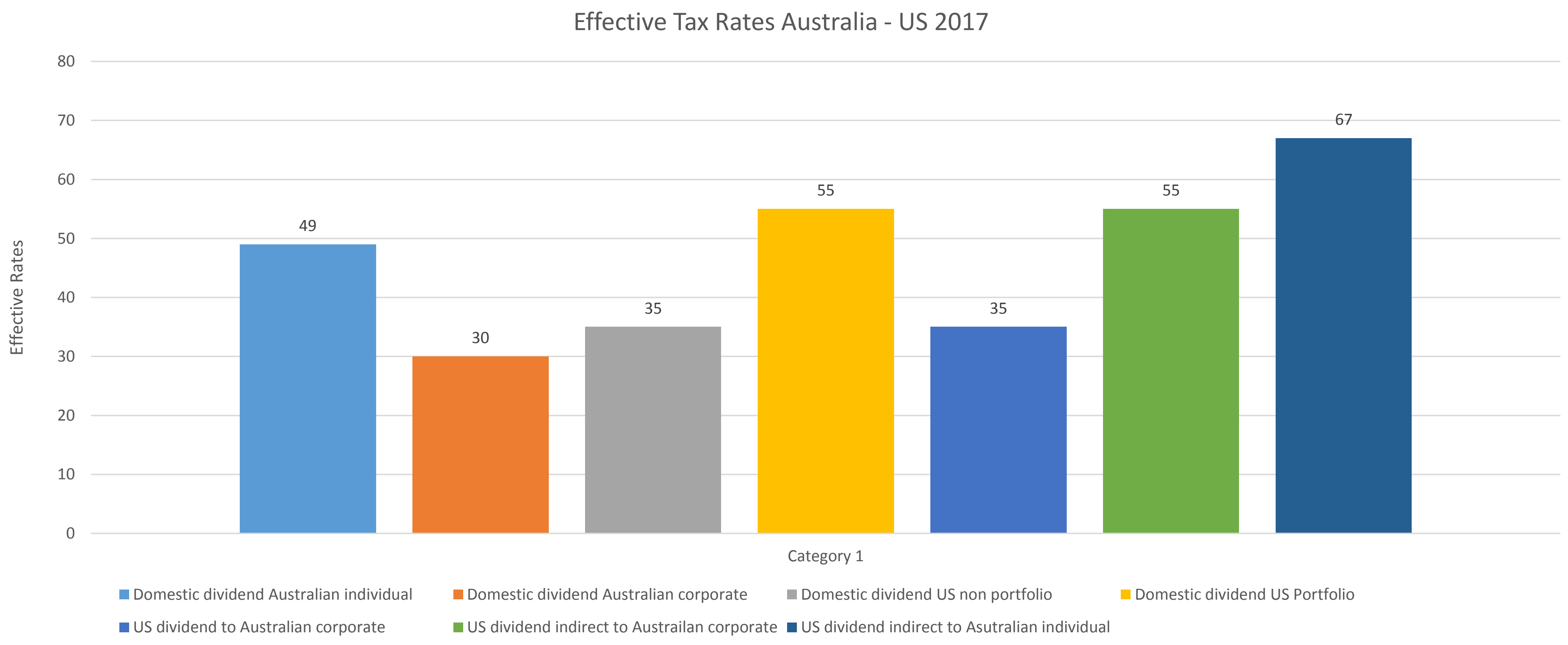
2017

- Discrimination against both individual and foreign residents by not extending imputation gross up and credit to them – foreign investors likely to seek to reduce Australian tax
- For active business exemptions produced CIN at direct corporate investor level
- Corporate tax preferences washed out on distribution – tendency for them to be retained at corporate level
- Breadth of active foreign source income exemptions likely to produce strategies to minimise foreign tax
- Imputation system provides incentive for Australian controlled companies to pay Australian tax
- For indirect investors interaction with imputation produced NN at underlying shareholder level
- Debt bias for domestic investors largely removed but still existed for cross border investors despite Thin Cap rules
- Taxation of active income arising in or diverted to low tax countries could be deferred indefinitely
- Excess credit position for US portfolio and non-portfolio investors

Effective Tax Rates Australia – UK 2017



Effective Rates Australia – US 2017



Some Conclusions

- Overall since 1918 CIN has been dominant policy for non-portfolio outbound corporate investment – favours repatriation of foreign profits
- Since 1940s NN has been the result where Australian companies redistributed non-portfolio foreign source income to Australian residents – favours retention at corporate level of foreign profits
- Imputation system provides incentive for Australian companies controlled by Australians to pay Australian tax but provides no incentives to pay foreign tax
- Since 1940s have discriminated against foreign corporate investors into Australia – discrimination against non corporate foreign investors is more recent – likely to distort investment choices by foreigners and leads to need for rules to prevent base erosion