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CEDA Study

THE TAXATION OF CORPORATE INCOME

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CHAPTER 2

THE AUSTRALIAN EXPERIENCE

THE SIGNIFICANCE OF COMPANY TAX IN THE AUSTRALIAN ECONOMY

Company tax is the second largest item of revenue for the Federal Government, representing 12% of total taxation revenue estimated to be collected nationally in 1980/81, second in importance as a source of Government revenue only to PAYE income tax on individuals. Table 1 shows that the significance of company tax, has, like most other taxes, declined as a proportion of total taxation collections over the past decade, reflecting the extremely high rates of growth of personal income tax collections over that period and the emergence of crude oil and LPG levies.

Until 1980/81, company taxation has been the slowest growing area of revenue collection of the six major bases of tax. Table 1 clearly illustrates the declining relative burden of company taxation.

Table 2 shows company tax collected as a percentage of the gross operating surplus of companies between 1968/69 and 1977/78.

It can be seen the burden has risen considerably over that period, although not in a consistent manner. The rising proportion of gross operating surplus subject to taxation over the period reinforces the point that the declining *relative* burden of company taxation over the 1970s is mainly due to the very substantial growth of other forms of taxation. This reinforces the conclusion of other papers in the CEDA Taxation Series that effective tax rates of bases have risen significantly in Australia in the 1970s.

FEATURES:

Corporation tax in Australia has taken the form basically of taxing corporation income in whole (i.e. without distinction between distributed and undistributed taxes except in the case of private companies) and, in addition, taxing individual shareholders at their marginal rate of income tax on dividends received in respect of investments in company equity.

The basis of taxation has, on the whole, been non-discriminatory over the past five years. Prior to the 1970s the Australian system set different rates of taxation to be applied to corporate taxation. The different rates were in respect of:

(a) the nature of the company - private or public; and

(b) the level of corporate profit attained.

TABLE 1

FEDERAL GOVERNMENT TAXATION RECEIPTS

	1969-70 $M.	% OF TOTAL EXCLUDING PAYROLL	1979/80 $M.	% OF TOTAL EXCLUDING PAYROLL	COMPOUND % GROWTH RATE PER ANNUM
Customs Duty	414.5	6.8	1,628.8	6.0	14.7
Excise Duty	939.7	15.5	4,965.0	18.2	18.1
Sales Duty	567.4	9.4	1,864.8	6.8	12.6
Income Tax - Individuals Net PAYE	2,084.2	34.4	12,160.3	44.6	19.3
Other	773.9	12.7	2,879.8	10.6	14.0
- Companies	1,197.4	19.8	3,406.5	12.5	11.0
Payroll Tax	264.1	-	15.7	0.1	-
Estate Duty	71.3	1.2	48.4	0.2	-9.6
Gift Duty	8.6	0.1	0.5	-	-
Stamp Duty	2.1	-	6.9	-	-
TOTAL TAXATION REVENUE	6,323.1	-	27,305.2	-	-
TOTAL TAXATION REVENUE EXCLUDING PAYROLL	6,059.0	100.0	27,289.5	99.0	16.2

SOURCE: Commonwealth Budget Paper No. 1, 1971/72 and 1980/81, Statement Number 4, Estimates of Receipts.

NOTES: Payroll Tax is excluded from the percentage calculations because of its transfer to State responsibilities in 1971, arbitrarily inflating the shares of other taxes if it had been incorporated in the calculations for 1979/80.

TABLE 2

TOTAL COMPANY TAX COLLECTED AS A PERCENTAGE OF GROSS OPERATING SURPLUS OF COMPANIES

FINANCIAL YEAR	COMPANY TAXATION $M.	GROSS OPERATING SURPLUS $M.	COMPANY TAX AS A PERCENTAGE OF GROSS OPERATING SURPLUS
1968-69	1,040	4,025	25.8
1969-70	1,197	4,645	25.8
1970-71	1,444	4,883	29.6
1971-72	1,535	5,287	29.0
1972-73	1,634	6,137	26.6
1973-74	2,033	6,713	30.3
1974-75	2,447	7,203	40.0
1975-76	2,618	8,341	31.4
1976-77	2,921	9,920	29.4
1977-78	3,213	10,274	31.3
1978-79	3,151	10,978	28.7
1979-80	3,547	12,759	27.8

SOURCE: Quarterly Estimate of National Income and Expenditure (ABS) 1978-79 Budget Paper No. 1, Statement Number 6.

TECHNICAL NOTE: As a rate with reference to the effective taxable base, it is more appropriate to relate taxation payments to surplus of the previous year, given the lag in tax collections. However, the table above relates the flow of profits and tax payments in coincident periods, a relation relevant to cash flow considerations of companies.

THE PUBLIC VS. PRIVATE COMPANY DISTINCTION

The Government has levied separate rates of taxation with respect of private and public companies up until late 1971 when a uniform rate was introduced (with the exception of 1951 when identical 45 per cent tax levies were raised). The differential between the two rates had been five percentage points for the period prior to 1952 until 1971.

The rationale for the differential had been the provision of Division 7 of the Taxation Act, whereby private companies paid a penalty rate of taxation on all profits retained above a stated proportion of corporate earnings. The enforced distribution of private company profits was designed to prevent high income earners becoming incorporated in order to avoid tax. However, insofar as legitimate private companies were adversely affected, a lower rate of company tax was utilised in order to offset the distributional restraint.

Table 3 below shows the rates of taxation applying to private and public company earnings respectively over the past 20 years.

A distinction in taxation rates has also been made historically between the earnings of public and private company tax rates and tax rates applying to mutual insurance, other life insurance, co-operative and non-profit companies and friendly societies. In general those distinctions have been eliminated in 1973 and 1974, with the exception of the first $10,000 of profit earned by co-operative and non-profit companies and all profits in respect of friendly societies.

Historically the Australian Taxation Office has distinguished between the first $10,000 earned and subsequent profits. The system thus contained an element of progressivity but in a simple, two step form. The differential of five percentage points in respect of public companies since 1952, and ten percentage points in respect of private companies between 1951 and 1971 (five percentage points in 1971 and 1972) was eliminated in 1971 in respect of public companies and in 1973 in respect of private companies and mutual insurance and other life insurance companies. The distinction remains in respect of co-operative and non-profit companies but at 2.5 percentage points, compared with five percentage points up until 1974.

The rationale for the distinction was obviously that of equity - higher corporate income earners paying higher taxation. The rationale is weak, however, in view of the failure of corporate tax rates to relate in any way to the income of the shareholders on behalf of whom these profits were earned.

REVENUE RAISED

Company tax has traditionally been responsible for around 18-19 per cent of Federal Government taxation revenue. The proportion has risen consistently over the period 1950 to 1970, but has fallen considerably over the 1970s (although real company tax has risen it has not kept pace with the massive rises experienced in personal income tax). Table 4 shows the proportion of Federal revenue raised through company tax.

TABLE 3

RATES OF COMPANY TAX

INCOME YEAR ENDED JUNE 30	TYPE OF COMPANY AND INCOME			
	PUBLIC		PRIVATE	
	FIRST $10,000	BALANCE	FIRST $10,000	BALANCE
1950	25.0	35.0(a,b)	25.0	30.0(c)
1951	45.0	45.0	25.0	35.0(c)
1952	35.0	45.0	25.0	35.0(d)
1953 to 1955	30.0	35.0	20.0	30.0(d)
1956	35.0	40.0	25.0	35.0(d)
1957 to 1959	32.5	37.5	22.5	32.5(d)
1960 to 1963	35.0	40.0	25.0	35.0(d)
1964 to 1967	37.5	42.5	27.5	37.5(d)
1968 to 1969	40.0	45.0	30.0	40.0(d)
1970	42.5	47.5	32.5	42.5(d)
1971 to 1972	47.5	47.5	37.5	42.5(d)
1973	47.5	47.5	45.0	45.0
1974	45.0	45.0	45.0	45.0
1975 to 1976	42.5	42.5	42.5	42.5
1977 to 1981	46.0	46.0	46.0	46.0

NOTES:
(a) Includes super tax of 10 cents in the dollar.
(b) Further tax of 20 cents in the dollar on undistributed income also payable.
(c) Further tax at shareholders' rates payable on undistributed income.
(d) Further tax of 50 cents in the dollar on undistributed income also payable.
(e) Effective rates depend also on tax concessions (TSVA, investment allowance, etc.) and the treatment of depreciation, for instance. These are not reflected in this table.

SOURCE: Mathews Report - "Inflation and Taxation", p. 351.
Budget Papers - 1975 to 1980.

TABLE 4

PROPORTION OF FEDERAL REVENUE DERIVED BY COMPANY TAX

1949-50	16.5	1975-76	15.5
1954-55	18.3	1976-77	14.4
1959-60	18.1	1977-78	14.5
1964-65	18.9	1978-79	13.04
1969-70	18.6	1979-80	12.5
1973-74	18.6	1980-81	14.2 (est.)
1974-75	17.7		

The reliance on taxation of corporate incomes is extremely high in Australia. The extent of that reliance is shown by a comparison of the proportion of income raised from company tax by several OECD nations in 1971 (Table 5).

TABLE 5

COMPANY TAX AS A PROPORTION OF TOTAL TAX REVENUE IN SELECTED OECD COUNTRIES

	1977
Australia	16.6
Canada	10.2
France	5.8
Germany	4.5
Italy	6.9
Japan	18.8
U.K.	7.8
U.S.A.	10.4
Av. of 22 OECD	7.3

The data show that only Japan has a higher reliance on corporate taxation (Japan also has the lowest level of total taxation as a percentage of GDP). Australia's reliance on corporate tax is abnormally high, being over twice that of the total OECD average.

THE CURRENT COMPANY TAX STRUCTURE

The current Australian company tax structure is that of the "classical system", where corporations and owners are taxed separately on the earnings of the company.

Several alternative systems of company taxation exist. The system most contrasting the current method of taxation is the "fully integrated system", where the corporation tax is effectively eliminated and shareholders are taxed on corporate earnings as individual income in the hands of the shareholder. Under this system, the purest alternative, company profit is taxed at the marginal individual income tax rate of each owner, whether or not profits are distributed.

There are, of course, several methods of company tax between the two extremes listed above. The most common is a split-rate system, under which company tax is paid at the corporate income level at two rates - a higher rate for undistributed profits and a lower (possibly) zero rate for distributed profits. Distributed profits are then taxed in the hands of the individual shareholder at his marginal rate of tax. Other systems, together with the above will be examined in the following chapter.

TABLE 6

COMBINED RATE OF COMPANY AND PERSONAL INCOME TAX UNDER PRESENT 'SEPARATE' SYSTEM, BY SIZE OF SHAREHOLDER'S INCOME AND PROPORTION OF PROFITS RETAINED

Shareholder's notional income (a)	Shareholder's marginal rate of personal income tax (b)	Combined company/personal tax expressed as a percentage of company profits, assuming proportion of profits retained is: (c)				
$	%	0%	25%	50%	75%	100%
2,000	15.4	55.6	53.6	51.5	49.5	47.5
5,000	33.3	65.0	60.6	56.3	51.9	47.5
12,000	48.2	72.8	66.5	60.2	53.9	47.5
50,000	66.7	82.5	73.8	65.0	56.3	47.5

(a) Including an attribution of company profits before tax according to his shareholding;

(b) On final increments of income as shown in previous column; 1973-74 rate scale;

(c) The company tax rate is taken as 47½%, the 1972-73 public company rate. The personal tax rate is as shown in the second column, implying that the amount of company profits attributable is modest enough to be wholly taxable at the one marginal rate.

THE "CLASSICAL SYSTEM" EXAMINED

The most common criticism of the current system of company tax in Australia is that it involves "double taxation" - taxation at the corporate level and then at the individual level as a personal income tax of dividends received. The problem, it is held, is that "double taxation" involves overtaxation. However, this is not always true as will be demonstrated shortly. *The important factors are the total amount of taxation raised from each shareholder in respect of a company's operations, the distribution of that tax take and its impact in terms of equity, efficiency and administrative implications.*

Using a stylized presentation, Table 6 demonstrates the distribution of tax paid by the individual shareholder given various assumptions as to personal marginal tax-rate and company profit distributions.

Table 6 above, shows that at all income levels, the effective rate of taxation is lower the greater the proportion of profits retained and the tax saving from a given level of retention is greater the higher the individual income.

The current system of company taxation is inequitable in that:

- it discriminates between individuals on the same income, depending on the retention policy of companies;
- it discriminates against low income earners investing in equity capital;
- it discriminates in favour of high income persons investing in equity capital.

EFFECT ON EFFICIENCY

The current corporate tax system fails the central efficiency test, that a tax should be neutral as between its effects on different types of enterprise and different types of investment. By its overtaxation of low income investors in equity capital, the tax system effectively discriminates against equity investment as against fixed term (debenture) investment and against investment in companies as against other forms of investment offering a similar return. The corporate tax system thus contributes to the widespread complaint from the corporate sector that equity capital from the small investor is not available. This situation also contributes to a reliance by companies in Australia on imported investment funds.

At the same time, however, the tax system has the opposite effect in respect of high income earners - it effectively discriminates in favour of equity investment and corporate investment as a whole. The precise net effect of the system on investment in companies compared with other investment and equity investment vs. fixed term investment is impossible to determine.

The classical system of company taxation causes a distortion in company practices by favouring the retention of profits. Given the absence of a capital gains tax, retained profits bear income tax

only at the corporate profit level; hence in order to minimise taxation on profits earned (whether distributed or not) companies are encouraged to retain profits.

THE EFFECT ON ADMINISTRATION

The current system *does* have clear administrative advantages over alternative schemes. It is extremely simple to tax all company profits at one rate of tax and to tax only distributed profits in the hands of the shareholder. The system avoids problems of determining marginal tax rates of all individual shareholders and determining a hypothetical distribution of profits. The system avoids many of the problems involved in alternative systems of company taxation (which will be examined in the next chapter). Indeed a simpler system would be difficult to devise.

CHAPTER 4

AN ALTERNATIVE TO THE CURRENT SYSTEM OF COMPANY TAXATION

The current (separate) system of corporate taxation contains several faults. First, inequities exist as private income derived from company activity is not taxed at individual marginal rates of taxation, to the benefit of some taxpayers and at the expense of others. The current system is also inefficient, by inducing high income earners to invest in companies and dissuading low income earners from doing so. Further, the system favours the retention of profits. Each of these effects introduces non-market influences upon the investment decision.

The faults of the current system, and the criticism thus caused (especially in relation to double taxation) have led to a search for an alternative system: one which overcomes the faults inherent within the present system.

What are the Alternatives?

A. A Hypothetical Distribution of Profits

This system would dispense entirely with company taxation and tax all company profits in the hands of individual shareholders. The hypothetical nature of the distribution would allow companies to maintain their normal distribution policy, and indeed allow them to distribute profits without concern about the taxation impact on their shareholders' income thus improving efficiency. Further, by taxing *all* income from company investments in the hands of the individual would remove the bias against low-income earners investing in companies. This might overcome to some degree the current lack of involvement of the low/medium income earner in the corporate capital market - a problem of concern to the business sector and one reason proposed traditionally as a cause of Australia's high reliance on overseas investment in the corporate sector.

The basis of any hypothetical distribution of profits would be the share holdings registered by each firm. Share registry records could be consulted, with profits being distributed in proportion to shares held. There may be some administrative problems, but they would be only slight. Profits would be distributed to each shareholder on the basis of the following formula:

$$\frac{\text{total profits}}{\text{total profits distributed}} \times \text{profits distributed to the shareholder.}$$

The formula is a simple one with all data being held by every company registered under the Companies Act.

There is, however, a serious problem associated with a hypothetical distribution system: non-resident shareholders can only be taxed at the level agreed to in double taxation agreements with the country of the shareholder's residence (if there is such an agreement). In the case of non-resident investors in Australian companies, most are resident in major countries, the U.S.A. and the United Kingdom especially. These companies have double taxation agreements with Australia, limiting taxation on dividend income to only 15 per cent. Such a tax would result in considerable revenue costs to the Australian Treasury, inequity relative to domestic shareholders, the lightly taxed dividends being derived on income earned in Australia through the exertions principally of Australians.

B. A Requirement that all Company Profits be Distributed

This method of taxation would have similar effects to the hypothetical distribution method above, and face the same problems in relation to overseas-based shareholdings. Administrative problems associated with the hypothetical distribution, insofar as they do exist, would be avoided.

The system would be based on a penalty tax on undistributed profits, of such a level as to induce the total distribution of company earnings. Company taxation would cease, except in relation to undistributed profits, and the taxation of company profits would, hopefully, take place entirely at the individual shareholder level at that rate of taxation appropriate to each shareholder.

The problems of the scheme are these: first, the method of taxation would fail adequately to tax the foreign shareholders; second, if the penalty rate of company taxation were to prevent tax avoidance by high income earners, the rate of taxation would have to be above the highest marginal rate of taxation on individual incomes. This rate would be absurdly high in relation to the low income earner. More seriously, the company tax rate would be high by world standards, causing problems in attracting foreign portfolio investment, and direct investment from overseas. If the penalty rate were effective in gaining full distribution of company profits, however, this would cease to be a problem.

The latter problems occur only where the penalty rate failed to achieve a full distribution of profits. The over-taxation of low income earners and the disincentive to foreign portfolio investment would then emerge as serious problems. Furthermore, the equity problem associated with our current taxation system would continue in respect of all undistributed profits.

C. Tax Actual Distributions and Accruals in Share Values

The system would again dispense with taxation at the company level, with individual shareholders being taxed on the basis of dividends received and accrued capital gains in relation to share values.

There are, however, serious administrative problems associated with a capital gains tax based on an accruals basis, including the problem of valuing shares for taxation purposes. The best system

would seem to be taxing on a basis of listed share prices; however, this would result in the taxation of share value appreciations not related to the retention of company profits. Further, taxation on an accruals basis would cause liquidity problems for some shareholders, forcing the sale of shares to pay taxation, resulting in distortions in relation to the availability of equity capital.

The problems associated with taxation on an accruals basis could be overcome by taxing capital gains on the basis of realisation. This, however, would cause problems in terms of efficiency by "locking in" share purchases (aimed at deferring taxation indefinitely) introducing a further distortion to the capital market.

In any event, it is inequitable to tax capital gains solely in relation to share values. The capital gains tax, ignoring its merits and problems, should, if introduced, be broadly based and not discriminate against one form of capital gain.

Further, the inability to distinguish between share appreciation arising out of retention policies of companies and other sources would make the taxation of capital gains in this manner impractical.

These problems could be overcome by introducing a capital gains tax in which *all* capital gains would be taxed, including those deriving from the retention of company profits. In this case the taxation of company profits would be achieved through a combination of personal income tax and capital gains tax. A *general* capital gains tax would overcome the problem of distinguishing between share appreciations arising through the retention of company profits and those arising through other causes. The problem of the 15 per cent taxation limit on income (or capital gains) earned by foreign shareholders would, however, remain unsolved.

It should be noted in relation to all of the above alternative schemes, tax schemes levied solely at the shareholder level, that the problem of lost revenue and inequity associated with the taxation of non-resident shareholdings continually arises. If the company tax rate were below the maximum rate of personal income tax, company investment would be utilised as a tax haven by those high income earners paying a higher rate of taxation. If the rate were high enough to avoid the creation of a tax haven the equity problem would still exist, in relation to the low income earner in particular, and company investment would be jeopardised. Further, the Australian rate of company taxation would be abnormally high by world standards, deterring foreign portfolio investment in Australia.

Overview

None of the alternative systems thus far examined adequately meets the criteria of a tax system. The failure to find a satisfactory system thus far leads logically to an examination of imputation systems or a split-rate system, systems which do tax at two levels, but attempt to overcome the problems of the current separate systems.

One alternative which may fill the requirements of an equitable method of taxing company earnings is an *imputation system*,

whereby the individual taxpayer will be taxed on his dividends and the company tax will apply to undistributed profits. In such a system company tax would be applied to all profits, but the individual shareholder would receive credits for company tax paid on distributed profits, thus overcoming one of the problems of the current system. Insofar as undistributed profits would be taxed at the same rate in respect of all shareholders, regardless of their marginal rate of taxation, the system would still not fulfil the equity requirements.

Another alternative is a *split-rate system*, which effectively introduces two tax rates on company profits - one in respect of undistributed profits and another in respect of distributed profits - the latter being less than the former (perhaps zero). The split-rate system again faces the familiar problem of being unable to tax dividends received by non-resident shareholders at a rate of taxation in excess of the 15 per cent rate laid down in double taxation agreements. As a result of this recurring problem, the split-rate system appears inappropriate as a method of taxing company income in Australia.

An Imputation System for Australia?

The mechanism of an imputation system is this. The shareholder's taxable income equals dividend received plus company tax paid by the company in respect of the shareholder's profits. The shareholder is taxed on this base income and then allowed a tax credit of the amount representing the company tax against his personal income tax liability. There are several systems of imputation, differentiated by different maximum rates of personal tax and different percentage imputation. In order to assess the impact of an imputation system relative to our current system, some examples are set out below, one utilising a full imputation method and the other a partial method.

It can be seen from Tables 7 and 8 that the imputation system significantly reduces the tax liability of the shareholder, both that tax paid by the company on his behalf and the tax paid on dividends received. But the imputation system severely over corrects, resulting in significant undertaxation of income derived from company investment. The tables indicate that the extent of undertaxation is greatest when a full imputation system is used, the full imputation system being less desirable than a partial system. The extent of inequity, although not illustrated by these tables, is greatest the smaller the proportion of company profits distributed. The imputation system is incapable of restoring equity by virtue of the tax at a flat rate (the company tax rate) on one part of profit earned. As a result the progressiveness of tax scales accepted in our personal income tax system are reduced.

It would seem, that due to the problem of being unable to tax non-resident shareholdings at a rate in excess of 15 per cent, a totally appropriate and equitable system of company taxation within Australia is not available. The requirement of such a system would be that company earnings are taxed in the hands of the individual shareholder at the shareholder's marginal rate of taxation.

TABLE 7

MECHANICS OF FULL IMPUTATION SYSTEM WITH DIVIDEND TAX CREDIT OF 100 PER CENT OF DIVIDEND RECEIVED: COMPANY TAX RATE 50 PER CENT AND 50 PER CENT DISTRIBUTION OF AFTER-TAX PROFITS

		SHAREHOLDER'S MARGINAL RATE				
		20%	30%	40%	50%	60%
1.	Company profit before tax	200	200	200	200	200
2.	Company tax (50%)	100	100	100	100	100
3.	Company profit after tax (1 - 2)	100	100	100	100	100
4.	Retained by company (50%)	50	50	50	50	50
5.	Dividend to shareholder (3 - 4)	50	50	50	50	50
6.	Gross upon dividend (5)	50	50	50	50	50
7.	Amount shown in shareholder's tax return (5 + 6)	100	100	100	100	100
8.	Tax (on 7) at marginal rate	20	30	40	50	60
9.	Tax credit (6)	50	50	50	50	50
10.	Tax payable by shareholder	-30	-20	-10	nil	10
11.	Total tax paid by shareholder and company (2 + 10)	70	80	90	100	110
12.	Tax paid under separate system by company and shareholder	110	115	120	125	130
13.	Net gain to shareholder	+40	+35	+30	+25	+20
14.	Tax payable by shareholder in his own hands	40	60	80	100	120
15.	Gain under imputation system (cf 14)	70	80	90	100	110

TABLE 8

MECHANICS OF PARTIAL IMPUTATION SYSTEM WITH DIVIDEND TAX CREDIT OF 50 PER CENT RECEIVED: COMPANY TAX RATE 50 PER CENT AND 50 PER CENT DISTRIBUTION OF AFTER-TAX PROFITS

	SHAREHOLDER'S MARGINAL RATE				
	20%	30%	40%	50%	60%
1. Company tax before tax	200	200	200	200	200
2. Company tax (50%)	100	100	100	100	100
3. Company profit after tax (1 - 2)	100	100	100	100	100
4. Retained by company (50%)	50	50	50	50	50
5. Dividend to shareholder (3 - 4)	50	50	50	50	50
6. Gross upon dividend (5)	25	25	25	25	25
7. Amount shown on shareholder's tax return (5 + 6)	75	75	75	75	75
8. Tax (on 7) at marginal rate	15	22.5	30	37.5	45
9. Tax credit (6)	25	25	25	25	25
10. Tax payable by shareholder	-10	-2.5	5	12.5	20
11. Total tax paid by shareholder and company (2 + 10)	90	97.5	105	112.5	120
12. Tax paid under separate system by company and taxpayer	110	115	120	125	130
13. Net gain to shareholder	+20	+18.5	+15	+12.5	+10
14. Tax payable by shareholder in his own hands	40	60	80	100	120
15. Gain under imputation system (cf 14)	50	62.5	75	87.5	100

This would seem to be an essential requirement, and should be approached openly in a straightforward manner. The problem of such a system would be the inability to tax foreign shareholders adequately.

Once the foreign investor constraint can be removed, we can examine systems which appear more equitable, and more efficient, than the current system of company taxation in Australia. Two alternatives which appeal are the introduction of a split-rate system designed to induce full distribution of company profits, or the introduction of a general capital gains tax which would have the effect of taxing capital gains resulting from the retention of profits by corporate management.

The inability to tax earnings on foreign investment at a rate in excess of 15 per cent (in general) provides a tremendous restraint on the ability of Australian Governments to abolish company tax and tax all income derived from company investment at the level of the individual investor. The failure to apply company tax to such earnings would result in significant revenue losses to the Australian Treasury, with withdrawals of foreign capital currently exceeding $1,500 million.

Withdrawals of capital in 1977/78 amounted to $1,561 million. Assuming that these profits from which these withdrawals had been taxed at the company tax rate of 46 per cent, some $1,330 million would have been collected in company tax in respect of these profits (although not necessarily in any one year). This amount represented over 6 per cent of total taxation collections in 1977/78 and it is clear that the Treasury could not afford to lose this revenue. An illustration of the significance of this revenue is gained from the fact that personal income taxation would have to be increased, on average, by 10 per cent to replace this revenue.

CONCLUSION

The present system of corporation income taxation results into distortions of market investment decisions and inequities in the allocation of disposable income to constituent owners. There are real difficulties in making fundamental changes in the system while income remains the main base of taxation, the capital gains portion of income remains untaxed and avoidance and evasion create such discrepancies between real taxable capacity and taxable income concepts. Greater reliance on consumption or expenditure as a basis for taxation would again overcome so many of these problems as advocated in CEDA's Taxation: Time to Change the Rules.