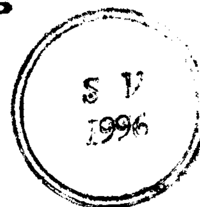
COMPARISON OF INCOME TAX SYSTEMS AND CORPORATE TAX RATES IN SELECTED COUNTRIES



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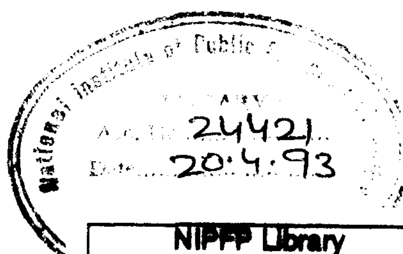

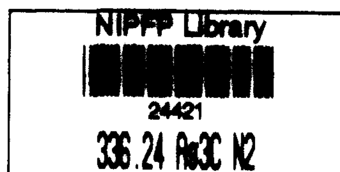

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COMPARISON OF INCOME TAX SYSTEMS AND CORPORATE TAX RATES IN SELECTED COUNTRIES

Pawan K. Aggarwal

Abstract

This study compares the forms of integration of personal and corporate income taxes across the 25 countries selected. Among these countries, nine follow classical system, sevel allow partial tax relief on dividends with full tax credit of corporate tax attributable to dividends, one follows the system of imputation of dividends with partial tax credit of corporate tax attributable to dividends, and two follow split-rate system.

A trend of reduction in the corporate tax rates has been observed. Among the 25 countries, four are found to have a tax rate of 30 per cent only and the tax rate does not exceed 35 per cent in thirteen countries.

COMPARISON OF INCOME TAX SYSTEMS AND CORPORATE TAX RATES IN SELECTED COUNTRIES

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I. Introduction

It is well known that the classical system (CS) of income taxation wherein separate taxes are levied on corporate and personal incomes, results in double taxation of corporate income. Double taxation of distributed dividends is widely discussed in the literature. Dividends distributed out of the post-tax income of corporate entities are added to the personal incomes of the shareholders and as such, are again subjected to tax under the personal income tax. Double taxation of retained earnings has, however, attracted lesser attention. Double taxation of retained earnings takes place because retained earnings out of post-tax incomes of corporate entities tend to result in an appreciation in the value of stocks or assets which is again subjected to tax under the personal income tax in the form of capital gains, as and when realised. The awareness about the double taxation of corporate income under CS and its ill-effects had increased over time. The trend of easing the burden of double taxation on the distributed dividends in one way or another, has set in. Brazil is the latest to exempt dividends from personal income taxation with effect from the year 1993.

The existence of corporate income tax is generally justified in terms of benefit of limited liability of the owners of corporate entities and the need to tax retained earnings of these entities which may escape taxation under the personal income tax through indefinite postponement of distribution of such accumulations or indefinite postponement of realisation of these accumulated earnings by the

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shareholders as capital gains. Irrespective of the soundness of the arguments in favour of existence of corporate tax, it is a fact that the corporate income tax has become a convenient source of tax revenues for most countries. In India, the yield of corporate income tax exceeds that of the personal income tax.

The only way to tax at least the retained earnings of the corporate entities and to avoid double taxation of corporate income is full integration of corporate and personal income taxes. This requires (i) full imputation of pre-tax corporate profits (both retained and distributed) to the shareholders in proportion to their shareholdings, (ii) full tax credit for their share of corporate tax against their tax liabilities under the personal income tax and (iii) raising the base price (cost) of a share by the extent of retained earnings per share. Adoption of full integration would imply substantial loss of income tax revenue. It is, perhaps, for this reason, that none of the countries in the world have resorted to the system of full integration (SFI) of corporate and personal income taxation. A trend of partial integration in one form or another has, however, been observed.

With a view to throwing some light on the current trends in avoidance of double taxation of corporate income and the corporate tax rates, the study compares the forms of integration of personal and corporate income taxes and the corporate income tax rates across 25 countries selected.

The outline of the study is as follows. Section II gives description of various partially integrated tax systems. Section III gives coverage of the study. Section IV contains observations regarding integration and the corporate tax rates. Section V gives concluding remarks.

II. Description of Partly Integrated Systems

Various partially integrated income tax systems can be distinguished and described as follows:

SIDPTC: **System of imputation of dividends with partial tax credit.** In this system, gross dividends (i.e., dividends plus corporate tax attributable to the dividends) of a shareholder are added to his personal income and a part of corporate tax attributable to his dividends is allowed as tax credit against his tax liability under the personal income tax.

SIDFTC: **System of imputation of dividends with full tax credit.** In this system, gross dividends of a shareholder are added to his personal income and a full tax credit of the corporate tax attributable to his dividends is allowed against his tax liability under the personal income tax.

SRS : **Split-rate system.** In this system, retained earnings and distributed dividends are subject to different rates of corporate tax. The latter are taxed at lower rate of corporate income tax resulting in partial tax relief on dividends.

SCTD: **System of concessional tax on dividends under personal income tax.** This includes partial or full exemption of dividends from personal income tax. This may take the form a final withholding tax on dividends on behalf of shareholders or separate taxation of dividends at a concessional rate.

III. Coverage

The study includes countries from Europe, Latin America, Africa, Asia and the Pacific. In all, 25 countries covered in the study are Australia, Belgium, Brazil, Denmark, France, Republic of Germany, India, Indonesia, Japan, Korea, Luxembourg, Malaysia, Mexico, New Zealand, Nepal, Nigeria, Pakistan, Philippines, Singapore, Sri Lanka, Taiwan, Thailand, United Kingdom, U.S.A. and Zambia. Tax systems followed and corporate tax rates in these 25 countries are given in Table 1.

IV. Observations Regarding Integration and Tax Rates

From Table 1, it will be noted that classical system of income taxation, in spite of its ill-effects, is not uncommon. Among the 25 countries studied, nine are found to follow classical system with no substantial provision of avoiding double taxation of corporate income. These countries are Australia, Belgium, India, Indonesia, Luxembourg, Nigeria, Sri Lanka, Taiwan and the U.S.A.

Among the 16 countries which follow a system of partial integration, seven allow partial tax relief on dividends, six follow the system of imputation of dividends with full tax credit of corporate taxes attributable to dividends, one (France) follows the system of imputation of dividends with partial tax credit of corporate tax attributable to dividends, and two (Nepal and Pakistan) follow the split-rate system. Among the countries which allow the tax relief on dividends, Brazil is the latest to exempt dividends from personal income tax.

From the above information it seems to follow that there is no special preference for a specific form of integration of corporate and personal income taxes. A country can adopt a tax system of full or

partial integration depending on its capacity in sacrificing tax revenue and in administering a complex tax system.

It will also be noted from Table 1 that among the 25 countries studied, only four (Germany, India, Sri Lanka and Zambia) have corporate income tax rates greater than 40 per cent. Tax rate is not found to exceed 35 per cent in 13 countries and the rate is found to be only 30 per cent in four countries (Brazil, Pakistan, Singapore and Thailand). Recently, Singapore, Sri Lanka and Thailand have resorted to reduction in corporate income tax rates. This reveals that the corporate tax rate in most countries falls in the range of 30 to 40 per cent. Interestingly, some of the countries are also found to exempt long term capital gains such as Australia and Belgium.

V. Concluding Remarks

The classical system of income taxation, in spite of its ill-effects due to double taxation of corporate income, is not uncommon. None of the countries follow the system of full integration though many have resorted to partial integration with a view to mitigating the burden of double taxation on distributed dividends.

The corporate tax rate in most countries is found to fall in the range of 30 to 40 per cent. Some of the countries are also found to exempt long term capital gains.

TABLE 1

Income Taxation in Selected Countries: Tax Systems and Corporate Tax Rates

Country	Tax System	Corporate Income tax rates (per cent) Assessment year	Domestic Co.	Foreign company	Remarks
(1)	(2)	(3)	(4)	(5)	(6)
Australia	CS	1992	39	39	LTCG's not taxed, excess retentions taxed at 50%.
Belgium	CS	1993	39	43	In general, LTCG's not taxed, lower tax rates apply if income is less then BF 13 million.
Brazil*	SCTD	1992	30	30	Special tax of 40 to 60% on remitted amount is payable if average of remittances of three consecutive years exceeds 12% of registered foreign capital. Shareholders have the choice to treat withholding tax of 8% on total profits (irrespective of distribution) or withholding tax on distributed profits at a higher rates as the final tax.
Denmark	SCTD	1992-93	38	38	Withholding tax of 30% on dividends is final tax if domestic dividends do not exceed 30600 DKr. per year for a single individual. Any dividends in excess of this figure are subject to an additional income tax of 15% imposed by assessment.
France	SIDPTC	1993	34	34	LTCG's are taxed at 18%. An annual lump-sum minimum tax based on the corporations turnover is payable. A tax credit (avoir fiscal) of 50% of distributed dividends is given to the shareholders.

Notes: * With effect from assessment year 1994 withholding tax on dividends is not to apply, thereby dividend will be exempt from income tax in the hands of shareholders.

CS : Classical System
SIDPTC : System of imputation of dividends with partial tax credit.
SIDFTC : System of imputation of dividends with full tax credit.
SRS : Split-rate system.
SCTD : System of concessional tax on dividends (including exemption) under personal income taxation.
LTCG : Long term capital gains.

Contd...

TABLE 1 (CONTD.)

(1)	(2)	(3)	(4)	(5)	(6)
Germany	SIDFTC	1993	50	46	Tax on distributed profits is 36% for which tax credit is allowed against income tax liability of a shareholder.
India	CS	1993-94	45. 50	65	In specified cases, royalties and technical fees received by foreign companies are taxed at 50%. Dividends received by shareholders from domestic companies are eligible for 100% deduction upto specified limits and exemption from withholding tax is also available under certain circumstances.
Indonesia	CS	1992	15-35	20	A final withholding tax at the rate of 20% is charged on gross income (including dividend) of non-residents. Withholding tax for residents is at the rate of 15%.
Japan	SCTD	1993-94	37.5	37.5	If capital employed in the corporation is less than Yen 100 million, then first Yen 8 million of annual income is taxed at 28%. Option to the shareholders of choosing final withholding tax of 35% on dividends subject to certain conditions. A special temporary surcharge of 2.5% will apply to corporation tax in excess of 4 million for the years 1993-94 and 1994-95.
Korea	SIDFTC	1992	20,34	20.34	Additional tax of 25% on excessive accumulated profits of unlisted large-scale corporations. Corporation income tax on distributed profits is treated as withholding tax on dividends on behalf of shareholders.
Luxembourg	CS	1992	33	33	
Malaysia	SIDFTC	1992	35	35	Corporate income tax on distributed profits is treated as withholding tax on dividends on behalf of shareholders.
Mexico	SCTD	1992	35	35	Dividends paid out of profits already taxed are exempt or are subject to a final 35% tax if not so paid.
Nepal	SRS	1992	40	40	There is no corporate income tax on distributed profits.

Contd...

TABLE 1 (CONTD.)

(1)	(2)	(3)	(4)	(5)	(6)
New Zealand	SIDFTC	1992	33	38	Corporate income tax on distributed profits is treated as withholding tax on dividends on behalf of shareholders.
Nigeria	CS	1991	40	40	For companies engaged in agricultural production etc. with annual turnover not exceeding N 500,000 the tax rate is 20%. Companies are liable to pay a minimum tax based on gross profit, net assets, paid-up capital and turnover. Enterprises engaged in agriculture or having at least 25% foreign equity capital are exempt from minimum tax.
Pakistan	SRS	1992-93	30	30	A minimum tax equal to 0.5% of turnover is payable. There is no corporate income tax on distributed profits.
Philippines	SCTD	1992-93	35	35	No personal income tax on dividends received from domestic companies.
Singapore	SIDFTC	1993-94	30	30	Shareholders receiving dividend from domestic companies are allowed a tax credit for the corporate tax attributable to the dividends received. No tax on capital gains.
Sri Lanka	CS	1993-94	40,45	40,45	Small companies are taxed at lower rates. Tax is withheld on dividends payable to the shareholders for which a tax credit is allowed against their personal income tax liabilities.
Taiwan	CS	1992-93	15-25	15-25	If a company does not distribute profits each year, the shareholders are, in effect, taxed as if they received a deemed dividend. System of withholding tax on dividends payable is prevalent.
Thailand	SCTD	1993-94	30	30	Shareholders can choose to pay final withholding tax of 15% on dividends receivable from domestic companies. Alternatively, normal rate of withholding tax applies which does not exceed 15% and they can avail of tax credit of 3/7th of the dividends against their personal income tax liabilities on dividends received.

Contd...

TABLE 1 (CONTD.)

(1)	(2)	(3)	(4)	(5)	(6)
United Kingdom	SIDFTC	1992-93	35	35	Tax rate of 25% applies if income of the company does not exceed £ 250.000. No withholding of income tax on dividends, but the company paying the dividend is liable to pay advance corporate tax (ACT) amounting to 1/3 of the dividends to be set off against its corporate tax liability (CT). The ACT payment is imputed to the shareholders as a tax credit against their income tax liabilities on the dividend plus credit.
U.S.A.	CS	1990-91	15-34	15-34	Tax rate of 34% applies to income in excess of US $ 75,000. In addition, 5% tax applies on taxable income between $ 100,000 and $ 335,000.
Zambia	SITD	1992-93	45	45	A final tax of 30% is withheld on dividends payable to the resident shareholders.

Sources: The following publications of International Bureau of Fiscal Documentation:

i. European Taxation for Belgium, Denmark, France, Germany, Luxembourg and United Kingdom.
ii. Corporate Taxation in Latin America for Brazil and Mexico.
iii. African Tax Systems for Nigeria and Zambia.
iv. Taxes and Investments in Asia and the Pacific for Australia, Indonesia, Japan, Korea, Malaysia, New Zealand, Nepal, Pakistan, Philippines, Singapore, Sri Lanka, Taiwan and Thailand.
v. Tax News Service (upto April 1992) for updating the compilation based on the earlier publications.

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