TAXATION OF BUSINESS INCOME

Non-taxation policy priorities often result in countries incorporating particular forms of investment incentives within their taxation systems. This affects the tax base used to calculate the liability of a taxpayer.

The straight-line write-off of buildings is generally four per cent or less while for equipment with a life of eight years, the median write-off rate is around 20 per cent. Australia is seen as having generous write-off rates for some types of longer life assets.

The variety of treatments of capital gains precludes generalisations. However, other countries examined tend to be more generous than Australia, although Australia has moved to a more preferential regime for small business.

The most common form of tax preference is for R&D. Australia's approach, providing a deduction of 125 per cent of amounts outlaid, is uncommon.

Introduction

Purpose

4.1 In theory, broadly equal tax treatment of all forms of business income is desirable in order to minimise distortions to relative prices and thus to investment decisions. Non-taxation policy priorities in some countries have resulted in the provision of incentives for particular types of investment, thus resulting in uneven tax treatment of income from different types of investment. Such incentives may be to the detriment of other types of activities; however, it is difficult to show conclusively that such policies are, in overall terms, damaging to the economy. Incentives may be justified in particular cases because of market, social and environmental deficiencies. Nevertheless, it is likely that the widespread use of incentives will result in distortions to the detriment of the economy in the long-term.

4.2 The purpose of this chapter is to examine in broad terms the taxation treatment of different forms of business income in different jurisdictions. It complements Chapter 3 which focuses on the treatment of particular forms of entities.

Approach

4.3 While the analysis presents by necessity a summary of the key features of business income taxation in each of the 14 countries in Group 1 and the 13 countries in Group 2, it contains sufficient detail to enable meaningful comparison. The focus here is on the following tax features:

- capital allowances for equipment, buildings, patents and goodwill;
- the tax treatment of inventory;
- the tax treatment of capital gains;
- the treatment of tax losses;
- the provision of taxation preferences;
- 'other' taxes on business income; and
- the use of accounting principles in determining taxable income.

4.4 This chapter focuses on the tax base used to calculate the tax liability of a taxpayer. The tax rate of course gives only one element of the total impact of the business tax system. A high nominal tax rate may be accompanied by a narrow base so that the overall effective tax rate is lower than may have been apparent.

4.5 In general, the discussion is confined to Group 1 countries. However, in the case of corporate entities, information is also provided for Group 2 countries.

Key comparisons

Capital allowances

4.6 Tables 4.1 and 4.2 present comparisons of the capital allowances for tax purposes, for selected fixed and intangible property in the Group 1 and Group 2 countries. In particular, the annual straight-line write-off rate for these assets for depreciation/amortisation purposes is examined. Specific features of the information summarised in these tables are discussed subsequently.

Table 4.1: Summary of annual depreciation rates (annual straight-line write-off) for selected assets — Group 1 countries

Country	Equipment (approximately 8 year life)	Buildings	Patents	Goodwill
Australia	20%	2.5% or 4% of original cost of building	5% (standard patents) 16.7% (petty patents)	Non-deductible
Canada	20%	4% of purchase price	Over useful life (straight-line basis), or 25% (declining balance rate).	7% (declining balance rate) allowable for 75% of cost with respect to purchased goodwill only.
Chile	17%	7.7% of purchase price	Deductible if self-created. Non-amortisable if acquired.	Non-deductible
France	10%-20%	2%-5% of purchase price	20%	Non-deductible
Germany	10%-30%	2%-4% of purchase price	Over useful life if acquired. Expensed currently if self-developed.	No amortisation allowed for self-developed goodwill (but policy under review). Purchased goodwill must be amortised over 15 years.
Ireland	15% from years 1 to 6 10% for year 7	4% of original cost	Over shorter of 17 years or beneficial period if acquired. Patent royalties expensed currently.	Non-deductible
Japan	12% straight line 25% declining balance	2% of purchase price.	12.5%	20%
New Zealand	18.6%	4% of purchase price	Amortisable over useful life.	Acquisition payment non-deductible. Preservation cost deductible.

Table 4.1: Summary of annual depreciation rates (annual straight-line write-off) for selected assets — Group 1 countries

Country	Equipment (approximately 8 year life)	Buildings	Patents	Goodwill
Netherlands	10%	2.5%-4%	Amortisable over useful life.	Self-developed goodwill non-deductible, acquired goodwill through asset deal amortisable over 5-10 years.
Singapore	20% initial allowance, balance over useful life.	25% initial allowance, 3% for subsequent years. Depreciation related to original cost with adjustment for initial year allowance.	Not available	Non-deductible
Sweden	20%	4%-5%of purchase price	20%	20% Goodwill related to purchase of stock is non-deductible.
Taiwan	11.11% (based on useful life plus one year)	1.96% 6.25%=1/(15+1) based on purchase price. Rates based on expected life plus one year.	Amortisable over beneficial period (cannot be amortised longer than 15 years).	Goodwill cannot be amortised longer than 20 years.
United Kingdom	17% (6% for useful life over 25 years).	4% based on original cost (industrial buildings and hotels only).	25% (diminishing rate)	Non-deductible
United States	1-27% (derived from double declining balance rate).	2.56% of purchase price	6.67% if acquired, non-deductible if self-created unless relating to acquisition of trade/business.	6.67% if acquired, non-deductible if self-created unless relating to acquisition of trade/business.

Table 4.2: Summary of annual depreciation rates (annual straight-line write-off) for selected assets — Group 2 countries

Country	Equipment (approximately 8 year life)	Buildings	Patents	Goodwill
Argentina	Depending on accounting useful life.	2%	Generally non-deductible.	Generally non-deductible.
Belgium	20%	3%	20% (minimum)	10%
Brazil	10%	4%	No amortisation	Amortisation allowed in limited circumstances over minimum period of 5 years.
China	Foreign investment enterprises (FIE): 10% (maximum). Domestic companies: vary depending on industry.	FIE: 5% (maximum). Domestic companies: vary depending on industry.	Amortised over beneficial term, or stipulated period in relevant patent regulations, or 10% (maximum).	10% (maximum) only for goodwill realised under ownership transfer.
Croatia	28.57% (maximum)	4%/5%/6.06%/8%/ 10%/20%/33.33%/ 40% depending on construction material.	40%	40%
Denmark	Approximately 20% (derived from reducing balance method).	1%-6% (5% from 1999)	100%	14%
Finland	Approximately 20% (derived from maximum diminishing rate, 25% from 1999).	4% for office, 7% for other business premises (diminishing rate).	Depending on useful life.	Depending on useful life.
Israel	15%-20%	1.5%-4%	Amortisable by certain industrial companies at 12.5%.	Non-deductible
Italy	10-15%	3%	33.3% (maximum)	20%
Malaysia	20% initial allowance, 8%-40% afterwards. Average 15-20%.	Approx 2.22% only for industrial buildings.	Non-deductible	Non-deductible
Mexico	10% (maximum)	5% (maximum)	10% (maximum)	Non-deductible
Norway	Approx 20% (derived from diminishing rate).	2% for offices, 5% for others (diminishing rate).	Amortisable over useful life.	30% (diminishing rate)
South Korea	10%/12.5%/16.67%/ 25%	5%/2.5%	10%	20%

Fixed property (equipment and buildings)

4.7 Costs of fixed assets are generally written off on a straight-line or declining balance basis for tax purposes. To allow for comparison, all rates have been converted to the approximate straight-line depreciation basis.

4.8 Most countries stipulate annual tax depreciation rates (or maximum rates) for different types of fixed assets, which need not conform with accounting treatment. The straight-line write-off rate is generally four per cent or less for buildings. For equipment, a range of rates apply but the median rate is around 20 per cent a year for equipment with an economic life of eight years (that is 12.5 per cent straight-line economic rate). Thus, Australia with a straight-line rate of 20 per cent is about average. In fact, the Australian rate is generally regarded as more generous for some types of assets than the table suggests, particularly for longer life assets. This arises because Australia allows broad banding of assets to determine the tax depreciation allowance. This tends to give generous rates for assets with lives in excess of about eight years.

4.9 Malaysia applies different rates for the first depreciation year and the subsequent depreciation years for machinery and equipment. On average, the equivalent straight-line rate is approximately 15 to 20 per cent a year.

4.10 Accelerated depreciation or a higher depreciation rate is available in some countries for assets relating to R&D investment, assets involved in highly changeable operations or assets with short effective life (such as computer hardware and software). To the extent that this represents preferential treatment, it is discussed later in this chapter.

Intangible property (patents and goodwill)

4.11 Intangible property is often treated separately depending on whether it is in the nature of patents or goodwill. Patents are able to be amortised in most countries, generally with the reservation that the amount has not already been claimed as a deduction. The rate varies substantially. In Australia the five per cent rate is based essentially on the effective life of the patent from a legal point of view. This may not equate to the economic life if the patent is unable to be exploited over its full legal life. The rate of amortisation tends to be higher in most other countries, although the rate is similar in the United States.

4.12 Purchased goodwill tends to fall into one of two categories. Many countries, including Australia, do not allow amortisation. Other countries, including the United States, allow amortisation with the rate often in the range 10 to 20 per cent. This represents a difficult area to determine what the appropriate economic treatment should be. Goodwill does not always decline over time or it may decline very unevenly. Moreover, tax systems allow for the deductibility of expenditure associated with maintaining goodwill. As a result, it is not surprising that there is no uniformity of treatment between countries.

Inventory valuation

4.13 Valuation of inventory for taxation purposes can significantly affect total tax liability, particularly in an inflationary environment or where the value of items of inventory is likely to vary for some reason. As is evident in Tables 4.3 and 4.4, the most common way of valuing inventories for tax purposes is by the lower of cost or market value on a FIFO basis. In some countries, the use of LIFO is optional and would generally be chosen by a taxpayer when available. The United States allows LIFO and it is also available to some extent in Germany, Japan, the Netherlands, and Taiwan as well as in several Group 2 countries.

4.14 Use of LIFO is particularly favourable to taxpayers in a high inflation environment or where there is some reason why inventory might appreciate. It was regarded as a particularly attractive feature of a tax system during the high inflation period of the 1970s and early 1980s. However, in a low inflation environment it probably does not lead to significant differences.

4.15 Some jurisdictions allow switching between valuation methods but the extent of flexibility varies substantially. Until recently, there was a high degree of flexibility in the tax treatment of inventory in New Zealand, but treatment has subsequently tightened. Significant restrictions on switching between methods have been imposed. In addition, whereas previously it was possible for share traders to use the specific identification valuation method, and to value shares at market value, which resulted in the highest cost base for tax purposes, this is no longer allowable. Shares must now be valued at cost, with FIFO and weighted average being the only permissible cost-flow methods.

4.16 In Australia, switching between valuation methods is allowed from year to year, so long as the closing value of an item at the end of any income year is adopted as its opening value for the subsequent year.

4.17 A number of other countries allow switching between methods and rules for valuing inventory. In some cases, this requires written approval of the revenue authority. More often, it is acceptable so long as there is economic or commercial justification and that it does not occur frequently.

Table 4.3: Summary of tax treatment of inventory — Group 1 countries

Country	Inventory valuation rule	Inventory valuation method
Australia	Cost, market selling value, replacement cost. Different rules may be adopted for each class and/or individual item of stock, and may be changed each year. The constraint on switching is that the closing value at the end of one income year automatically becomes the opening value at the beginning of the next year.	FIFO, average cost, standard cost. Same switching rules as for inventory valuation.
Canada	Lower of cost and market value, market value. May switch to another rule if the latter provides a more accurate measurement of income.	FIFO, specific identification. Same switching rule as for inventory valuation rule.
Chile	Cost	FIFO, weighted average. The price level restatement rules make switching between methods immaterial.
France	Lower of cost and market value	FIFO, specific identification. FIFO is not allowed unless it is impossible to determine the real value of each item of inventory.
Germany	Cost	LIFO, weighted average, specific identification. Switching not allowed unless with reasonable economic arguments.
Ireland	Lower of cost and net realisable value	FIFO, specific identification. Switching possible if the method to be switched to can most closely approximate value.
Japan	Cost, lower of cost and market value, most recent purchase price. Selected rule must be used for at least three continuous business years. Switching between rules requires prior approval of tax office.	FIFO, LIFO, weighted average. Same switching rule as for inventory valuation method.
New Zealand	Cost, lower of cost and market value. Different rules may be used for different types of inventory. Switching between years possible, but opening value of one income year equals closing value at the end of preceding year.	FIFO, weighted average, specific identification. Switching between methods allowed only if consistent with accounting standards.
Netherlands	Lower of cost and market value.	LIFO, FIFO, HIFO (highest in, first out), base-stock. No switching between methods allowed.
Singapore	Lower of cost and net realisable value.	FIFO, specific identification, weighted average. Switching between methods allowed with commercial justification.
Sweden	Commercial accounts value, not below lower of cost and market value.	FIFO. The chosen method must be used on total inventory, but possible to change between years.
Taiwan	Cost, lower of cost and market value. Once the lower of cost and market value rule is applied, switching to another method is not allowed.	Weighted average, FIFO, LIFO. Switching between methods allowed between fiscal years with commercial justification, but application for change must be filed with the tax office for approval.
United Kingdom	Lower of cost and net realisable value.	FIFO, weighted average. Switching between methods are governed by UK GAAP; no specific tax rules.
United States	Cost, lower of cost and market value. Same rule must apply to both beginning and ending inventories within a year. Switching between years allowed.	FIFO, LIFO (raw materials only), specific identification. LIFO election is irrevocable and, once adopted, must be used in later years unless the IRS authorises a change pursuant to written request by the company.

Table 4.4: Summary of tax treatment of inventory — Group 2 countries

Country	Inventory valuation rule	Inventory valuation method
Argentina	Cost	FIFO
Belgium	Lower of cost and market value	FIFO, LIFO, weighted average. Switching between methods generally not allowed.
Brazil	Lower of cost and market value	FIFO, weighted average
China	Cost	FIFO, LIFO, shifting average, weighted average. Switching between years allowed upon prior approval of tax authority.
Croatia	Value with reference to International Accounting Standards	FIFO, average price
Denmark	Normally lower of cost and market value	FIFO, weighted average
Finland	Lower of cost and market value	FIFO, LIFO, weighted average
Israel	Lower of cost and market value	FIFO
Italy	Lower of cost and market value during last month of the tax year.	LIFO
Malaysia	Lower of cost and market value	FIFO, unit cost, average cost. Switching between methods not allowed.
Mexico	Cost	FIFO, LIFO and other methods authorised by Mexican GAAP.
Norway	Lower of cost and market value	FIFO
South Korea	Lower of cost and market value	FIFO, LIFO

Capital gains

4.18 Tables 4.5 and 4.6 compare the treatment of capital gains in each of the Group 1 and Group 2 countries respectively. This tends to be an area where other countries provide more generous treatment than does Australia, although the outcome depends on the rate of inflation and how long assets are held. In addition, Australia has moved to a more preferential treatment of small business.

4.19 It is difficult to generalise about the treatment of capital gains in individual countries because of the extent of variations. Some countries do not explicitly tax capital gains but tax may apply if the amount is in the nature of ordinary income under other concepts. Such concepts vary between countries but usually relate to whether the nature of the business is such that income would generally be expected to arise from the realisation of gains.

4.20 Most countries provide preferential taxation treatment of capital gains, particularly where the gain is realised by an individual taxpayer. The preference may take the form of exemption if the asset is held for a minimum period (for example, Germany and Singapore) or a reduced rate of tax (for example, Canada and the United States). A third alternative is to exclude a certain proportion of otherwise assessable capital gains from taxation. Canada also follows this route by excluding 25 per cent of gains from taxation. While Australia taxes the gain at normal rates of tax, it does provide full indexation of the cost base, as do Argentina, Israel and Mexico.

4.21 Australia does not allow capital losses to be offset against other income. A number of other countries allow such offsets, including Brazil, Finland, Italy, Norway and South Korea. It appears that this offset is generally only allowed where the assets disposed of are business assets.

Table 4.5: Summary of tax treatment of capital gains — Group 1 countries

Country	Capital Gains
Australia	NIT, or CGT when gains not taxed under NIT or other provisions. CGT only applied to inflation adjusted gains. Gains from goodwill (50%, from sale of small business), trading stock, motor vehicles, small business retirement disposals and compensation for damages for wrong doing may be exempt from CGT. Rollover relief for replacement of active assets (including business assets and intangibles such as goodwill but excluding most financial assets) in small businesses within 1 year before and 2 years after the replacement. Rollover relief also for certain reconstructions, but not for scrip-for-scrip swaps. Capital losses can only be offset against capital gains.
Canada	NIT. Scrip-for-scrip rollover available if both companies are Canadian and prescribed rules followed. Rollover for business asset replacement with an asset of a similar type within 1 year following the end of the taxation year in which the original asset was purchased. Exempt on 25% of gains generally; also exempt on gain on disposal of principal residence and first $500,000 on disposal of qualified farm property or qualified small business corporation shares. Capital losses can only be offset against capital gains.
Chile	As a general rule, capital gains are subject to NIT (for example, First Category Tax (FCT) if derived by a company). Non-recurrent sales (of shares in particular) by companies are not subject to further tax when the proceeds are used to fund dividends. Dividends funded from this source are not taxed. The 15% FCT paid on capital gains at the company level is therefore a final tax. Capital losses can generally be offset against other income, with some restrictions on share sales.
France	As a rule, capital gains are subject to normal income taxation. Reduced income tax rate of 23.75% for long term net capital gains, that is, capital gains on shares held for more than two years, provided such shares represent more than 10% of the subsidiary's share capital or a value of more than FRF 150 million.
Germany	NIT. Gains from disposal of privately held properties beyond stipulated speculative holding periods (i.e. 2 years for real estate, 6 months for other assets) are exempt (proposed change in year 2000 to 10 years and 1 year respectively). Capital losses can be offset against other income.
Ireland	CGT. Exempt for gains from disposal of certain government securities, Irish life assurance policies and deferred annuities, accrual to an exempt pension fund or charity, National Savings Schemes, prize bonds, scrip-for scrip transactions, woodlands, certain wasting assets. Rollover relief for disposal of shares in professional/trading companies under certain conditions. Capital losses can only offset capital gains.
Japan	NIT. Capital gains from the sale of domestic land are subject to a surtax of about 12% or 6% for holding periods of less than 5 years and more than 5 years respectively (suspended until 2000). Capital losses can be offset against other income. Where a merger or amalgamation includes the cancellation of shares for shares in the new entity, the tax basis in the old shares is retained.
New Zealand	No CGT but gain may be taxed as ordinary income in special cases.
Netherlands	NIT. Exempt for gains on sale of shareholding if recipient qualifies for participation exemption. Deferral for gains from certain business assets (if being replaced by similar assets) which is then offset in the purchase price of the new assets, thereby reducing allowable depreciation.

Table 4.5: Summary of tax treatment of capital gains — Group 1 countries

Country	Capital Gains
Singapore	NIT for gains on disposal within 3 years of purchase: For sales of real property (including shares in private real property companies), 100% of the amount of gains are taxable if disposed of within a year from the date of acquisition, 66.67% of the amount of gains are taxable if disposed of after 1 year but less than 2 years from the date of acquisition, 33.33% of the amount of gains are taxable if disposed of after 2 years but less than 3 years from the date of acquisition, and non-taxable if sold 3 years after date of acquisition. Otherwise capital gains not taxed unless treated as ordinary income.
Sweden	NIT at 28% for companies and 30% for individuals. Rollover possible for intra-group sale of shares or when consideration consists of shares in purchasing company. Government currently considering new rules for group reconstructions. No rollover for asset replacement. Capital losses of a company can be offset against other income. For individuals, capital losses can be offset against all income from capital (including dividends and interest).
Taiwan	NIT. Exempt for gains from Taiwan securities and sale of land (subject to land value increment tax). Capital losses on taxable assets — land and securities are not taxable assets — can be offset against other income.
United Kingdom	CGT. Exempt on gains from wasting chattels, motor vehicles, sterling debentures. Rollover relief for replacement of certain business assets, assets transfer among same CGT group (75% common UK ownership), scrip-for-scrip exchanges under certain conditions. For companies, capital losses can only be offset against capital gains.
United States	CGT at 28% for corporations; maximum rate of 20% for individuals if asset held 18 months. Exempt on gains from like kind exchanges, capital contributions to corporations. Rollover relief for involuntary conversions and investments in qualifying small business corporations. Scrip-for-scrip exchanges generally exempt. Capital losses can only offset against capital gains.

NIT apply normal income tax
CGT apply capital gains tax

4.22 A second key feature of the taxation of capital gains is the extent to which rollover relief is available for business assets and for so called 'scrip-for-scrip' transactions. This is the standard approach in Canada, Ireland, Japan, Sweden, the United States and the United Kingdom. Conditions typically apply but these are generally not burdensome. This type of relief assists and potentially encourages group restructures, mergers and takeovers. Of course, such relief is less important in the numerous countries which exempt gains on the disposal of shares under certain conditions.

4.23 In Australia, rollover relief is essentially confined to those cases which involve some type of reconstruction of the business but where there is no change in the underlying asset or its ownership. More general relief is available to small business through the exemption for gains on goodwill. Many other countries provide broader relief. In particular, some countries allow liability for capital gains tax to be deferred when a business disposes of one asset and purchases another of a similar kind. The capital gain may affect either the amortisable value or the cost base of the replacement asset so that tax is deferred through the life of the replacement asset. Examples of this treatment include Canada, Netherlands, the United Kingdom and the United States.

Table 4.6: Summary of tax treatment of capital gains — Group 2 countries

Country	Capital Gains
Argentina	NIT with inflation adjustment. Losses from disposal of shares can only offset gains of same type.
Belgium	NIT. Gains on shares generally tax exempt.
Brazil	NIT. Losses on business assets offset against other income.
China	NIT
Croatia	NIT, but capital gains (except from share trading) currently not taxed.
Denmark	NIT at normal corporate rate. Gains/losses on inter-company balances are tax-free/non-deductible. Gains on shares may be tax-exempt. Reduced taxable basis may be available for gains on disposal of real estate.
Finland	NIT. Losses deductible against ordinary income in the year they are incurred.
Israel	NIT with indexation. Gains on shares and debentures in listed companies are tax-exempt. Gains on assets under mergers may be exempt. Capital losses can be carried forward for 7 years to offset capital gains.
Italy	NIT. Gains on shares/going concerns may be subject to reduced rate of 27%. Losses deductible from other income in the year they are realised.
Malaysia	Gains are exempt from tax except for real estate property.
Mexico	NIT with inflation adjustment. Losses on shares deductible against gains from same source and can be carried forward for 5 years.
Norway	NIT. Losses on business assets deductible from ordinary income in the year they are incurred.
South Korea	NIT. Extra 22% surcharge applicable to gains from sale of real estate. CGT applicable on gains from disposal of investment by non-residents. Losses deductible from ordinary income.

NIT apply normal income tax
CGT apply capital gains tax

Treatment of tax losses

4.24 The treatment of losses generally centres around whether the carry-back of losses (that is the offset of current losses against tax already paid in earlier years) is allowed and the nature of any limitation on the carry-forward of losses. Most countries allow some carry-back of operating losses although the period may be very short, generally no more than two to three years. The only countries that do not allow any form of loss carry-back are Australia, New Zealand, Singapore, Sweden and Taiwan. Japan has suspended the carry-back of losses but this is intended to be reinstated with effect from 2000. Germany allows carry-back but this is currently under review.

4.25 A summary of the treatment for Group 1 countries is shown in Table 4.7. No countries allow for the cashing out of losses except where loss carry-back is permitted to years in which income tax has been paid. The treatment in France is a little unusual. Taxpayers are permitted to carry back losses to earlier years where tax has been paid. In this way, the taxpayer can earn a non-interest bearing credit which can be carried forward to offset against future tax liability. If this credit is not used in five years, it is refunded.

4.26 Losses can be carried back for a number of years ranging from one year (Ireland and Japan) to an indefinite period (Chile). Seven of the 14 countries in Group 1, including Australia and New Zealand, allow tax losses to be carried forward indefinitely subject to passing a test for continuity of ownership of the business entity or for maintenance of the type of business activity.

4.27 Most countries also allow some form of group loss transfers. In Australia, this can only occur in cases of 100 per cent common ownership. A number of other countries, including New Zealand and the United Kingdom, have more generous provisions. Sweden and the United States are also more generous but there are other features about their provisions that complicate the matter. For example, in the United States, no grouping of losses is possible outside the consolidation provisions. In Sweden, loss grouping per se is not allowed but a similar result can be achieved by distributions of taxable and deductible amounts between companies with at least 90 per cent common ownership.

Table 4.7: Summary of treatment of tax losses — Group 1 countries

Country	Treatment of tax losses	Transfer (see more details in Table 3.6)
Australia	C/f indefinitely, subject to majority continuity of ownership test, or same business continues after change. No c/b	Yes, for 100% common ownership.
Canada	C/f for 7 years. C/f allowable if carrying on same business with a view to profit. C/b for 3 years	No. But careful planning may achieve the same result.
Chile	C/f indefinitely C/b indefinitely No restrictions on continuity of ownership or same business apply.	No
France	Ordinary losses c/f for 5 years, c/b for 3 years. Losses cancelled if company experiences a major change of activity. Net long term capital losses, c/f for 10 years against net long term capital gains.	Special restriction on loss transfers under merger.
Germany	C/f indefinitely, or c/b up to DM10 million for up to 2 years and c/f the balance indefinitely. Limited restrictions apply to c/f. Removal of c/b currently under consideration.	Yes, within consolidated group.
Ireland	C/f of trading losses until change of ownership or business. Manufacturing losses, c/f only against 10% income in each subsequent year. C/f not allowed if there is a change of business, or if the volume of trade has become negligible and subsequently becomes profitable. C/b of trading losses against profits before charges, with limit applied according to proportion of income (e.g. 10% loss in Year 2 offset up to 10% income in Year 1).	Yes, for common ownership of at least 75%.
Japan	C/f for 5 years. C/f not available with mergers and liquidation. C/b for 1 year (suspended until 2000).	No

Table 4.7: Summary of treatment of tax losses — Group 1 countries

Country	Treatment of tax losses	Transfer (see more details in Table 3.6)
New Zealand	C/f indefinitely (upon satisfying specified shareholding threshhold). No c/b	Yes, for grouping within consolidated group and groups with at least 66% commonly held interests.
Netherlands	C/f indefinitely C/b for 3 years	Yes, within consolidated group.
Singapore	C/f indefinitely, subject to shareholding remaining 50% or more unchanged as at certain dates between losses arising and their offset. No c/b.	No
Sweden	C/f indefinitely, so long as the entity continues to carry on the business. No c/b	No. But the same result can be achieved by distributions between entities with at least 90% common ownership. The distributions can flow in either direction between affiliates. Does not apply where one of the companies is an investment company.
Taiwan	C/f for 5 years under certain conditions. No c/b	No
United Kingdom	Trading losses c/f indefinitely, c/b 1 year. If loss incurred in final 12 months of trading, c/b 3 years. Non-trading losses only c/f indefinitely. C/f unless there is more than 50% change in ownership, and there is a substantial change in the business.	Yes. Trade loss transfers within 75% commonly held groups. Offset of other income in same year or previous 12 months.
United States	C/b losses prior to 6 August 1997 for 3 years. C/f remaining losses for 15 years. C/f is complex. There is a 'dollar per year' limitation based on the value of the entity and the amount of the c/f loss. Furthermore, to use the losses, both the consolidated group and the individual purchased entity must have income. Post 5 August 1997 losses c/b 2 years and c/f 20 years.	Yes, within consolidation provisions.

C/f carry-forward
C/b carry-back

4.28 The picture is somewhat different with Group 2 countries (see Table 4.8). South Korea is the only country in this group that allows loss carry-back and then only for one year. In addition, more countries in this group limit the number of years for which losses can be carried forward.

Table 4.8: Summary of treatment of tax losses — Group 2 countries

Country	Treatment of tax losses	Transfer
Argentina	C/f for 5 years No c/b	No
Belgium	C/f indefinitely No c/b	Special restriction on loss transfers under restructuring, acquisition or change in control of company.
Brazil	C/f indefinitely (limited to 30% of taxable income of a year). No c/b	No
China	C/f for 5 years No c/b	Yes, for domestic holding companies and subsidiaries, but not for foreign investment enterprises.
Croatia	C/f for 5 years (adjusted by protective interest rate (6.68% for 1997) annually).	No
Denmark	C/f for 5 years. 15-year c/f is allowed for losses from hydrocarbon exploitation not deducted from other income No c/b	Loss transfers allowed among Danish company with wholly-owned domestic and foreign subsidiaries.
Finland	C/f for 10 years No c/b Losses deductible against ordinary income in the year they are incurred.	No. But intra-group contributions (i.e. income transfers) are allowed.
Israel	C/f indefinitely (trading losses offset against trading income, capital losses against capital gains). No c/b	Yes, for industrial (broadly manufacturing) companies with 66.66% or more owned subsidiaries in common production line.
Italy	First 3-year operation loss c/f indefinitely, subsequent losses c/f for 5-years. No c/b	No
Malaysia	C/f indefinitely (business losses offset against business income, tax depreciation against income from same source). No c/b	No
Mexico	C/f for 10 year No c/b	Yes, for certain holding companies and majority owned subsidiaries.
Norway	C/f for 10 years No c/b, except losses from liquidation or winding up may be c/b for 2 years.	No. But intra-group (under 90% common ownership or more) contributions (i.e. income transfers) to loss companies are allowed.
South Korea	C/f for 5 years C/b for 1 year (only allowed for small and medium-sized companies). Special restriction applies under group restructuring.	No

C/f carry-forward
C/b carry-back

Provision of taxation preferences

4.29 Countries provide a range of preferences to business. Many OECD countries have gradually reduced their incentives over the years but certain capital allowances and specific treatment for particular industries are still commonplace. As shown above, capital allowances tend to be accelerated in most countries. Although this does not explicitly favour one industry over another, the size of any advantage provided does depend on the capital intensity of the industry benefiting from accelerated depreciation.

4.30 Most countries provide tax preferences of one form or another and a summary description of these preferences appears in Tables 4.9 and 4.10 for the Group 1 and Group 2 countries, respectively.

4.31 The most common form of preference is for R&D where almost all the countries considered provide some preference. Australia provides for deduction of 125 per cent of amounts outlaid on R&D. This type of approach is not common although it is notable that Malaysia allows a deduction equal to 200 per cent of the R&D outlay (on a range of eligible expenditures that is more limited than those in Australia).

4.32 The most common form of R&D preference appears to be immediate deductibility or accelerated write-off of capital expenditure. Israel provides generous grants for R&D which can range up to 66 per cent of the project cost. Similarly, generous direct funding for R&D (principally related to defence activities) is provided in the United States.

4.33 The 10 per cent tax rate in Ireland for manufacturing activity is one of the best known and widespread preferences available. This rate is coming under increasing pressure within the European Union because of the competitive benefit it is seen to provide. Ireland will progressively decrease its standard company tax rate until it reaches 12.5 per cent in 2003. This reduction will eventually lead to alignment with the rate for manufacturing but the 10 per cent rate for manufacturing will stay in place until at least 2010.

4.34 It is also common to provide preferences for high technology and for financial services. Some countries (including Canada, France, Brazil, Croatia, China and Croatia) provide preferences for particular geographic areas which are economically disadvantaged.

Table 4.9: Summary of tax preferences — Group 1 countries

Country	Preferences	
	R&D	Others
Australia	Expenditure deductible at the rate of 125%.	Various preferences for mining and quarrying industry - full deduction of exploration expenditure, allowable capital expenditure, transport facilities expenditure, rehabilitation expenditure. Capital allowances such as 100% 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. 7% tax credit for manufacturing and processing companies.
Chile	Capital expenditure amortisable over 1 to 6 years.	None
France	Expenditure written off immediately or amortised over 5 years. Tax credit for expenditures limited to FF40 million, with excess credit c/f for maximum 3 years.	TH (2-year exemption, 3-year 75%/50%/25% rebate) for companies in designated areas. AD (over 12-month) for certain assets (e.g. software, energy-saving equipment, anti-pollution building). Headquarters and distribution centres in designated areas may adopt cost-plus tax basis.
Germany	Expenditure deductible (except for contract R&D costs).	Investment grants (in cash) for acquisition or manufacture of certain assets in the 5 new states at 5%/8%/10% of investment costs. Extra depreciation allowance of up to 40% for fixed assets acquired/constructed within certain time frame. Depreciation preference for the 5 new states. Special preferences for capital investments (e.g. small and medium sized companies).
Ireland	100% capital allowance for capital expenditures by trading company, non-capital expenditures expensed currently.	10% tax rate for much of manufacturing. AD (from 25%-75%) for buildings in designated areas. 10-year double deduction of rent paid under qualified lease in designated areas. 10% RR for sales income of manufacturing companies. Preferences for global financial services to non-residents by International Financial Services Centres or in Shannon area, for example 10% RR, no withholding tax, double rent deduction for 10 years, treaty access, 10-year local property tax exemption. Various investment/development allowances for mining companies.
Japan	Non-capital expenditures expensed currently, capital expenditures amortised over beneficial period. 20% tax credit relating to incremental increase in R&D cost.	AD for certain assets. Special deduction for overseas technical services. Special reserves for qualified companies, e.g. overseas investment loss reserve for domestic companies.
New Zealand	Non-capital expenditures expensed currently, capital expenditures amortised over 5 years.	AD for all assets other than buildings. Mineral mining exploration and development costs 100% deductible including for planned expenditure up to 2 years in advance of expenditure. Most forestry expenditure immediately deductible.
Netherlands	Non-capital expenditures expensed currently, capital expenditures amortised over beneficial period.	ID for total investments of NLG3,700-545,000 in certain assets. AD for certain assets. Energy ID limited to NLG80 million. Exempt for liquidation profits, limited to NLG45,000. Preferences for employee training, maritime shipping promotion, group finance activities.

Table 4.9: Summary of tax preferences — Group 1 countries

Country	Preferences	
	R&D	Others
Singapore	Expenditure incurred on R&D undertaken directly by a person carrying on a trade/business (except on fixed assets) or related to that trade/business, or payments made by him to an approved R&D organisation, is tax-deductible. Further deductions may be granted on approved R&D projects, subject to certain conditions.	TH and investment allowance (up to 100% extra write-off of fixed assets) for manufacturing entities. Development and expansion incentive for high-tech industries. Possible preferences for banks and financial institutions and trading companies. RR (10%) for certain activities, e.g. cyber trading (offshore trading of approved entities via E-commerce).
Sweden	Non-capital expenditures expensed currently, capital expenditures amortised over 5 years.	None
Taiwan	Expenditures deductible or amortisable under certain conditions. AD for equipment used for R&D. 15%-20% ITC for investment in R&D.	AD for certain industries, equipment used for quality inspection, energy conservation. 5%-20% 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 20% ITC for investment in certain industries in low development areas, payment for certain shares. ITC or 5-year TH for qualified scientific/technology and investment companies.
United Kingdom	No specific preferences available.	Initial allowance of 40% on plant and machinery for small and medium companies.
United States	Expenditures either expensed currently or capitalised for amortisation over 60 months (minimum). Tax credit for qualified expenditures, limited to tax liability of the year. Excess credit c/b 1 years and c/f 20 years.	Deduction or amortisation (over 10 years) for certain domestic exploration expenses. Foreign mining exploration and development amortisable over 10 years.

TH tax holiday
RR reduced rate
AD accelerated depreciation
ID investment deduction (allowance against taxable income)
TR refund
DWT dividend withholding tax
ITC investment tax credit

Table 4.10: Summary of tax preferences — Group 2 countries

Country	Preferences	
	R&D	Others
Argentina	Available for export-oriented investment.	TH for companies in designated zones. However, all tax preferences for manufacturing companies are currently suspended.
Belgium	AD for intangibles resulting from R&D. ID for large entities for investment in R&D.	ID for small and medium sized entities. AD for new assets. ID for large entities for investments in energy saving and patents.
Brazil	No specific tax preferences.	10-year 75% or 37.5% tax reduction for projects in north-east and northern region.
China	Available for R&D investment of domestic companies.	TH (2-year exemption, 3-year 50% reduction) for production enterprises. RR (15%, 24%) for entities in certain industries and locations. TR (40%, 100%) for reinvestment or retained earnings.
Croatia	No specific tax preferences.	Higher protective interest rate (15%-20%) for investment in war devastated areas.
Denmark	No specific tax preferences.	Tax exemption may be available to headquarters companies.
Finland	No specific tax preferences.	Special tax relief (e.g. AD up to 50% increase) for new investments in production or tourist industry.
Israel	Government grants at 5%-66% of approved expenditures. Non-capital expenditures (net of government grants) deductible and capital expenditures amortisable over 3 years under certain conditions. Hi-tech companies may qualify as approved enterprise and eligible for various tax incentives.	Approved enterprises in manufacturing and tourism industry: possible RR (10~25%), AD and reduced DWT rate (15%) for 10 years. Headquarters companies: 10-year exemption on international trading income and capital gains, 20-year exemption from DWT for foreign source income.
Italy	Not specified in laws.	Tax credit for new recruitments by small and medium entities in designated areas until 2000. Tax credit for capital goods acquired by small and medium retail entities, up to ITL50 million.
Malaysia	Range of preferences including 200% deduction for expenditure in certain cases. Contract R&D companies may be entitled to tax exemption on 70% of taxable income for 5 years or investment tax allowance within 5 years from approval date.	TH (exemption on 70% of taxable income) or investment tax allowance available to promoted projects. Reinvestment allowance for qualifying projects. Infrastructure allowance for related expenses for entities in promoted areas. RR of 10% on management fees, interest and royalties received by qualified operational headquarters. Special preferences for venture capital companies, unit trusts, insurance business, approved service projects, etc.
Mexico	No specific tax preferences.	RR of 17% for exclusive farming, fishing and timber industry. RR of 25.5% for taxpayers generating majority revenue from the above industry. 17% for income from book publishing.
Norway	Non-capital expenditures expensed currently, capital expenditures amortisable over expected life.	No significant tax preferences.
South Korea	5%/10%/15% tax credit relating to technology development expenditure for companies carrying on R&D business. 5% tax credit relating to cost for R&D facilities.	5%/10%/15% tax credit relating to technology development expenditure for companies carrying on other qualified business. TH (5-year exemption and 3-year 50% reduction) for foreign owned entities. Withholding tax exemption on interest income derived by foreign financial institution from foreign exchange banks in South Korea.

TH tax holiday.
RR reduced rate
AD accelerated depreciation
ID investment deduction (allowance against taxable income)
TR tax refund
DWT dividend withholding tax

Other taxes affecting business

4.35 The discussion so far has focused on the application of income tax to business profits. A range of other taxes also affect business in different countries. These include wealth taxes, property taxes, transaction taxes (not including VAT type taxes) and taxes on employment. A summary of these for Group 1 countries is provided in Table 4.11.

4.36 Two countries apply an alternative minimum tax, namely Canada (in some provinces) and the United States. In Canada, the tax base is essentially a measure of accounting profit and applies to companies with assets or turnover which exceed minimum levels. The definition of the base in the United States is more complex. The starting point is normal taxable income but then adjustments are made to remove the extent to which a company can benefit from tax preferences. A tax rate of 20 per cent is then applied to this base.

4.37 France also applies a direct local tax — referred to as 'Business Tax' — which is based on assets and wages. It is not, however, an alternative tax but is paid on top of any income tax payable, with a deduction against income tax.

4.38 The most common additional tax is that which applies to the level of wages and salaries paid to fund various social security and retirement income benefits. As noted in Chapter 2, this represents a major source of revenue in most OECD countries. In Singapore, compulsory pension fund contributions represent 40 per cent of wages and salaries paid, with the employer able to recover up to half of this from the employee. With effect from 1 January 1999, the total rate of contribution will be reduced to 30 per cent, with the employee's contribution remaining at 20 per cent. The only similar tax in Australia is payroll tax applied at the State/Territory level. The Superannuation Guarantee charge paid by employers to provide a minimum level of superannuation support for employees, though not a tax, is of a similar nature.

4.39 There is considerable conjecture over the incidence of these taxes, an issue that in fact applies to all taxes applied to business and makes it difficult to draw conclusions about the impact of taxation on competitiveness. One view is that the incidence of taxes tends to fall on the factors of production that are less mobile, particularly land and labour. However, the picture is more complicated where exchange rates are able to adjust with relative freedom.

Table 4.11: Summary of 'other taxes' in Group 1 countries

Country	Taxes on wealth	Taxes on property	Taxes on goods and services (other than VAT)	Taxes on employment
Australia		States apply stamp duties on wide range of property transactions	Excise duties Customs duties Financial transactions taxes	States apply payroll tax
Canada	Capital tax on companies, corporate minimum tax in some provinces	Property taxes	Excises	Canada Pension Plan, Employment Insurance Scheme
Chile		Real estate tax Municipal tax		Social security levy
France	Minimum corporate tax based on turnover	Asset transfer taxes Registration duties		Salary tax Apprentice tax Vocational training tax Residential construction tax Social security levy
Germany		Real estate tax		Social security levy Payroll tax
Ireland		Property rates Stamp duties Share capital duty Vehicle registration tax	Excise duties	Pay-related social insurance
Japan		Stamp duties Business registration tax Licence tax Property tax	Custom duties	Health insurance Employees' pension insurance Unemployment insurance
Netherlands	Wealth tax on net asset value	Real estate usage tax Capital tax on shares	Customs duties Excise duties	Social security levy Payroll tax
New Zealand		Stamp duty	Gift duty Gaming duties Excise duties Customs duties	Employer premium
Singapore		Stamp duties Property tax	Customs duties	Skills development fund levy Foreign workers levy Central provident fund contributions are vested to the individual
Sweden		Stamp duties		Social security contributions paid by employer on behalf of employee. In total, the rate is about 33% of remuneration but deductible for income tax purposes.
Taiwan		Land value tax Stamp duties Vehicle licence tax	Customs duties Commodity tax	
United Kingdom		Local council property tax Stamp duties	Excise duties	National Insurance

Table 4.11: Summary of 'other taxes' in Group 1 countries

Country	Taxes on wealth	Taxes on property	Taxes on goods and services (other than VAT)	Taxes on employment
United States	Alternative minimum tax Accumulated earnings tax Luxury excise tax	Franchise tax Stamp duties Rent tax Environmental tax	Customs duties Environmental tax	Unemployment tax Payroll tax

Use of accounting principles

4.40 The calculation of taxable income is often contrasted with the calculation of accounting income for the purpose of statutory reporting. In practice, there tends to be considerable common ground between the two measures of income, with the degree of commonality varying significantly between countries.

4.41 Most Group 1 countries have a basic approach to determining taxable income whereby the starting point is accounting profit based on statutory accounts. The taxation provisions then provide for the circumstances in which variations from accounting principles need to be applied. These variations may also be supplemented by judicial interpretation.

4.42 The approach in Australia is a little different in that there is less formal recognition of accounting standards. The calculation of taxable income starts with assessable income and subtracts allowable deductions without reference to statutory accounting income. In practice, the approach may be little different as company taxpayers typically begin with statutory income and make the necessary adjustments to arrive at taxable income.

4.43 There are two essential differences in the treatment between countries. Firstly, most countries have explicit recognition of accounting principles. In the United States, for example, the Internal Revenue Code provides that the taxble income of a taxpayer must be computed in accordance with the method of accounting regularly employed in keeping the taxpayer's books. Further the taxpayer may not change the method of accounting without obtaining advance permission of the IRS. European countries, notably France, Germany and the United Kingdom appear to rely even more heavily on accounting principles.

4.44 Secondly, all countries include variations from accounting standards in their tax provisions. These variations cover a wide range of issues including depreciation, amortisation of good-will, entertainment, provisions for bad debts and warranties, and foreign exchange gains and losses. The extent of adjustments varies considerably between countries.

4.45 One area where this is evident is the treatment of provisions in accounts to allow for future events which, while uncertain, are nevertheless statistically likely to happen. The most common such reserves are for bad debts and inventory obsolescence. In addition, provision may be made for more probable events such as retirement benefits.

4.46 On the basis of the Group 1 countries surveyed, it appears that tax authorities generally take a tougher approach to the deductibility of such reserves than the accounting treatment would allow. For example, provisions for bad debt are generally not allowed unless the debt is specifically identified as being uncollectable. No countries in the group, other than Taiwan, allow a fixed percentage of debt to be regarded as unrecoverable even where there is statistical support for the number. Taiwan limits the deduction to no more than a fixed percentage of receivables.

4.47 Sweden in fact, includes a tax provision which is more favourable than the accounting treatment. Taxpayers are allowed a 'periodisation' reserve, whereby up to 20 per cent of taxable income can be transferred to a deductible reserve. The allocations to this reserve must be reversed within five years. This provides a means for averaging income but it also reflects acceptance that the taxation treatment of reserves generally was tight prior to the introduction of this measure in 1994.