PUBLIC TAX TRANSPARENCY

What the numbers do and don't mean

cta

Summary

Appropriate public transparency of tax information is critical to building public confidence in the tax system. Any information that is disclosed should be presented in a way that can best achieve these objectives.

For the last 10 years, the Commissioner of Taxation has been required under section 3C of the *Tax Administration Act 1953* to publish total income, taxable income, income tax payable and petroleum resource rent tax payable (where applicable) amounts for all public and foreign-owned corporate tax entities with a total income over $100 million and Australian-owned private companies[1] with total income of $100 million or more.

The reporting this information is intended to discourage large companies from engaging in aggressive tax avoidance practices and provide more information to better inform public debate on tax policy[2].

Although we support the objectives of this measure, the interaction of complicated tax and accounting rules and the number of steps required to move from total income to taxable income to tax payable can lead to confusion around what those particular numbers mean - and don't mean.

In essence:

- The disclosure of total income, taxable income and tax payable does not give an accurate picture of a company's tax performance or its tax performance relative to other companies.
- What these numbers show is that even in a very simple example, careful analysis is needed. It shows that a narrative around the industry in which a company operates, the stage of the investment cycle it is in and other factors is critical in assessing if a company is paying the right amount of tax.

This publication is aimed at making these numbers more meaningful, addressing some of the more common misunderstandings around what the numbers really mean.

About the CTA

The Corporate Tax Association (CTA) is the peak representative body on tax issues for over 150 large corporates operating in Australia.

The CTA serves as the collective voice for its members, playing a vital role in fostering collaboration between tax professionals, corporations, policymakers and the government to ensure the development of sound and effective tax laws (in particular, those applying to large corporates) and ensuring these laws are administered efficiently and effectively.

A list of the CTA's members and more information on the CTA can be found here: www.corptax.com.au.

Total income or turnover is not always relevant to how much tax a company should pay

Total income disclosed on a tax return is also referred to as gross income, gross turnover, turnover, revenue or gross revenue.

It is not the same as profit.

Total income is essentially the gross amount derived from selling goods and services **before** taking into account the expenses incurred in deriving that amount. Total income does not take into account costs (such as wages or other expenses) incurred in earning that total income. A company with a large total income figure will not always translate to profits or tax payable. In fact, according to the Australian Taxation Office, between 20% and 30% of economic groups listed on the ASX incur a loss each year, so you would expect similar numbers are not paying tax as a result.[3]

It is only in very rare cases where a company derives total income without incurring any expenses would multiplying total income received by 30% gives you a meaningful measure of tax performance.

Total income also includes:

- certain types of income that are not subject to Australian tax;
- are for policy reasons taxed concessionally;
- have a tax offset applied to them;
- are taxed in the hands of shareholders; and
- Government imposts such as excise.

These include

- certain foreign dividends received from subsidiaries operating in foreign jurisdictions;
- profits from foreign branch operations operating in foreign jurisdictions;
- franked dividends received from Australian companies;
- income from property trusts that is taxed in the hands of the beneficiaries at their marginal rate rather than at the corporate level;
- unrealised gains from asset revaluations; and
- excise on products sold (such as petroleum and tobacco excise) even though the full amount is remitted to the Government.

Tax is payable on taxable income not accounting profit

Although there are similarities between how accounting profit and taxable income are determined, they are different concepts. To assume a company should be paying 30% tax on its accounting profit in a particular year can be misleading.

It is helpful to remember that company tax is levied on taxable income according to taxation law, while accounting profit is measured according to accounting standards which are governed by corporate law. The differences in accounting profit and taxable income are broadly attributable to the different objectives behind the accounting and tax regimes:

- Accounting rules are aimed at providing investors and regulators with an accurate picture of the economic state of a company at a single point in time, being the company's year-end. Accounting profit tries to match the derivation of income with expenses associated with that income. Some accounting standards require certain assets to be revalued at market value and any movement in that value from year to year is reflected in accounting profit or loss, even though that gain (or loss) has not been realised.

- Tax rules are generally more 'binary' and look at income separately than expenses, and thus don't always 'match' in an accounting sense. Tax rules look at the 'derivation' of income and whether an expense is 'incurred'. Tax rules can also have a policy element to them. For example, denying some deductions (such as fines) or accelerating a deduction to stimulate economic activity (such as the instant asset write-off for small businesses).

Taxable income and accounting profit are different concepts

Taxable income is defined as assessable income less allowable deductions. It varies from accounting profit due to policy decisions made by Governments that are embedded in tax law design to either encourage or discourage certain types of behaviour. For example, penalties are not deductible. Other income received, such as foreign dividend income, is included in accounting profit but is treated as exempt income for tax purposes as the income has already been taxed in the foreign jurisdiction and to tax it again would amount to double taxation.

These differences almost invariably result in a company's tax liability not equalling 30% of accounting profit. Accountants classify the differences in the calculation of taxable income and accounting profits as either permanent and temporary (or timing) differences.

What are the most common permanent differences?

Permanent differences generally reflect tax policy decisions, such as when the tax law does not assess amounts to tax, applies a different rate of tax or does not allow a tax deduction.

Some examples of permanent differences include:

- The tax differential on profits derived in countries that have a tax rate that differs from 30%;
- Certain profits derived by 'stapled groups' such as property trusts which are not taxed at the company level but in the hands of the unitholders;
- Receipts of franked dividends;
- Receipts of certain exempt dividends from foreign subsidiaries;
- Research and development incentives;
- Non-deductible penalties;
- Certain capital gains and losses on disposal of interests in foreign entities;
- Utilisation of prior income or capital losses where a current or deferred tax asset is not currently recognised for accounting purposes; and
- Current year and carry forward tax losses that for accounting purposes are not seen as recoverable as it is unlikely future profits will be generated to utilise them.

What are the most common temporary (timing) differences?

Temporary (or timing) differences arise on items that are assessable or deductible for both tax and accounting purposes, but the point in time at which the amounts are assessable or deductible is in a different financial year for tax purposes than is booked as income or an expense in the financial statements.

Some examples of temporary differences include:

- Income for accounting purposes may be booked in a different period than for tax purposes;
- Differences in book and tax depreciation rates, reflecting a deduction can be claimed over a different period than for accounting purposes;
- Employee entitlements are deducted in calculating accounting profit as they accrue but are only tax deductible when paid;
- Accounting provisions for bad and doubtful debts are deducted in calculating accounting profit as they accrue but are only deductible for tax purposes when the debt is considered bad;
- Accounting rules that deduct certain costs on an accruals basis but tax rules that only grant a tax deduction when expenses are incurred;
- Utilisation of carry-forward tax losses that have been previously booked for accounting purposes; and
- Some costs are capitalised on the balance sheet rather than expensed in the profit and loss statement but may be deductible for tax purposes as incurred.

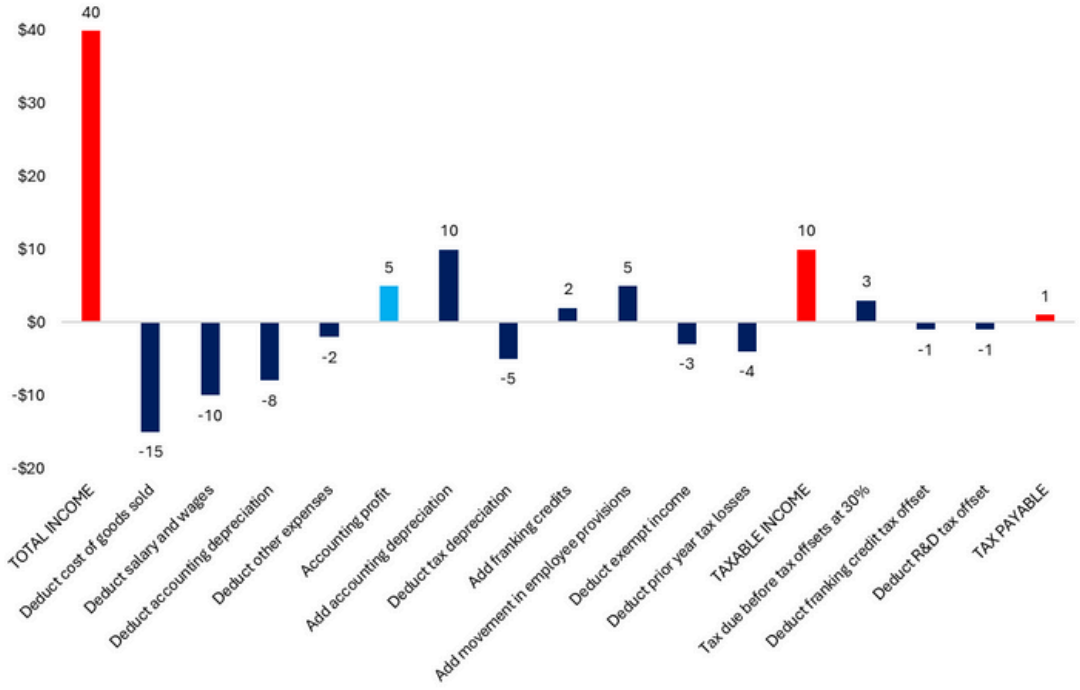
Such temporary differences are reflected in financial accounts via the booking of provisions for current tax and provisions for deferred tax liabilities (where tax will be paid in the future) or current and deferred tax assets (where items such as carry-forward losses are expected to reduce future tax payments).

The relationship between total income, taxable income and tax payable

The diagram below shows a simple example of the build-up from total income to accounting profit and some of the tax adjustments that may be required to calculate taxable income and finally income tax payable of a hypothetical company. The red columns highlight the three figures that are publicly disclosed and show they reflect only a part of the total tax picture.

The light blue column is the accounting profit of the company which is the total income figure less costs incurred in deriving that income. The dark blue columns represent the adjustments that are made to accounting profit to arrive at the taxable income figure, and then after adjusting for tax offsets (such as franking credits and the R&D incentive) resulting in the amount of income tax payable.

Diagram 1: From total income to tax payable



A company's effective tax rate will rarely equal 30%

A company's effective tax rate is generally not equal to the statutory rate. This is due to the interaction of the tax and accounting rules outlined above. Publicly listed companies as a matter of course explain any variation in tax liability from the 30% statutory rate in their published accounts as well as provide data on taxes paid during the year in cash flow statements[4]. Some companies also provide further breakdown and analysis of their tax position in other publications[5].

The disclosure of total income, taxable income and tax payable does not give an accurate picture of a company's tax performance or its tax performance relative to other companies.

We have highlighted in the following table a simple example of three hypothetical companies showing data of total income, accounting profit, taxable income and tax payable. We have assumed all three companies operate in the same industry, have derived the same accounting profit, however, their total income and total accounting expenses vary. We also assume the companies are at different stages in the investment cycle and thus their respective accounting and tax depreciation amounts, carry-forward losses and tax offsets for research and development are different.

Table 1: Tax return for the year ended 30 June 2024

Label on tax return	Description on tax return	A Ltd ($m)	B Ltd ($m)	C Ltd ($m)
6S	Total income	300	600	900
6Q	Total Expense	150	450	750
6T	Total ptofit or loss	150	150	150
	Tax adjustments • depreciation • carry forward losses	 -50 -50	 0 0	 50 0
7T	Taxable/net income or loss	50	150	200
T1	Tax on taxable or net income	15	45	60
E	Refundable tax offsets (R&D)	-4	-2	-1
T5	Tax payable	11	43	59
	Tax payable divided by total income Tax payable divided by taxable income	4% 22%	7% 29%	7% 30%

As the table shows, tax adjustments and tax offsets are driving the tax outcome. A has the same accounting profit as B and C, but because its tax depreciation is higher than accounting depreciation and it has carry-forward losses for this particular period, it is paying less tax than B and C. The fact that A ratio of tax payable to total income is 4% whereas B and C have ratios of 7% is not evidence of tax avoidance. Similarly, the fact that A has a ratio of tax payable to taxable income of 22% and that this is lower than B (29%) and C (30%) does not mean it is avoiding up to 8% tax.

What these numbers show is that even in a very simple example, careful analysis is needed. It shows that a narrative around the industry in which a company operates, the stage of the investment cycle it is in and other factors is critical in assessing if a company is paying the right amount of tax.[6]

End Notes

1. From the 2023 income year onwards, information from Australian-owned private companies with an income of $100 million or more will be included.
2. See TAXATION ADMINISTRATION ACT 1953 - SEC 3C Reporting of information about corporate tax entity with reported total income of $100 million or more.
3. See the ATO website which discusses the matter at Tax is not simply 30% of profit.
4. Companies that are publicly listed outside of Australia provide the same analysis of tax liabilities relative to their home country's tax rate.
5. For example details on the Voluntary Tax Transparency Code can be found at: Voluntary Tax Transparency Code.
6. Further explanation of public tax transparency data can be found on the ATO website at Tax transparency – report of entity tax information.