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20 February 2015

Committee Secretary
Senate Economics References Committee
PO Box 6100
Parliament House
Canberra ACT 2600

For the attention of: Dr Kathleen Dermody

Dear Dr Dermody

Re: Inquiry into corporate tax avoidance and minimisation

We refer to your letter dated 27 October 2014 regarding the current Inquiry referred to above. Although submissions to this Inquiry were requested to be made by 2 February 2015, a late lodgement of a submission was agreed in your telephone conversation with Keith Sheppard of this office on 28 January 2015.

Before responding to the specific terms of reference, it is worth noting that AGL Energy Limited ("AGL") is predominantly an Australian based group of companies and currently has very little or negligible activities outside Australia. Accordingly, many of the terms of reference of the Inquiry are not relevant to AGL. Furthermore, the key criticisms raised by the Tax Justice Network ("TJN") in their paper entitled "WHO pays for our common wealth? Tax Practices of the ASX 200" – which appears to have been the catalyst for the Inquiry – also do not apply to AGL. The key criticisms in that paper relate to thin capitalisation, transfer pricing, the use of "Secrecy Jurisdictions" and the use of tax aggressive measures to reduce the Effective Tax Rate ("ETR").

AGL's shareholder base is also mainly Australian and AGL strives to pay fully franked dividends to its shareholders. The dividend imputation system actually encourages Australian based companies to comply with the tax laws to pay the right amount of tax. It is in the interests of Australian based companies with Australian based shareholders to frank their dividends to the highest level possible. Ultimately, AGL acts largely as a conduit for the payment of tax by Australian resident entities and individuals.

This submission will therefore focus on the following:

1. Information and commentary on AGL's ETR for the years ended 30 June 2010 to 2014;
2. The adequacy of Australia's current tax laws;
3. Any need for greater transparency to deter tax avoidance; and
4. The performance and capability of the Australian Taxation Office ("ATO").

AGL's Effective Tax Rate

Table 26 in Appendix 4 of the TJN report referred to above asserts that AGL had an average annual ETR for the seven years to 30 June 2013 of 24% and that the average annual tax foregone by AGL was $26m per annum.

Unfortunately, we have been unable to reconcile to the 24% tax rate referred to in the report. Furthermore, AGL rejects that there has been any "tax forgone" as a result of the way that it conducts its tax affairs. However, we set out in the Appendix to this letter our own analysis of income taxes payable by AGL for the years ended 30 June 2010 to 2014 and the ETRs during these years.

The main conclusions that can be drawn from the analysis in the Appendix include the following:

- With regard to Tax Expense on Underlying Profits, the ETR for all years is close to the corporate tax rate of 30%. Where there are variances from the 30% tax rate, they are both small and readily explicable by reference to the application of all relevant tax laws to AGL's business.

- With regard to Tax Expense on Statutory Profits, the variances between the ETR and the 30% corporate tax rate are greater. However, as set out in more detail in the Appendix, they are readily explicable by reference to the application of the tax laws and the key elements giving rise to the variances can be summarised by the following:

    - The application of *changes* to tax law (for example, the extension of the Petroleum Resource Rent Tax and amendments to the tax consolidation legislation);
    - The results of tax review activities following the conclusion of tax audits and amendment requests by the ATO;
    - The difference between the accounting and tax treatment of business acquisitions and disposals and the treatment of impairment of assets.

The adequacy of Australia's current tax laws

Australia has some of the most complex and robust tax legislation in the world, including a comprehensive general anti-avoidance rule as well as many specific anti-avoidance rules. Whilst the corporate tax system is generally robust enough to protect the Australian tax base, the tax law is actually sometimes overly complex and large corporates operating in Australia would be well served with a reduction in this complexity and the provision of greater certainty in the corporate tax regime.

AGL has a comprehensive Tax Risk Management Policy which has been signed off by its Board of Directors. This policy plays an important part in the way that AGL conducts its tax affairs and seeks to fulfil its compliance obligations and protect its reputation in this area.

As pointed out in the TJN report, the corporate tax system continues to provide significant revenue flows for the Australian Treasury. If there are significant differences between reported profits and cash taxes payable, it is often as a result of specific incentives provided by the tax law (for example, research and development, exploration expenditure, etc.). If additional corporate taxes are to be raised – which we do not endorse or think is necessary or desirable – a change in the tax law is probably the most likely way to achieve this as it is likely that the great majority of Australian listed public companies in the ASX 200 fulfil their tax compliance obligations. Having said that, it is to be acknowledged that there needs to be a balance between collecting revenues and enhancing productivity and growth in the Australian economy.

The need for greater transparency to deter tax avoidance

For the last seven years AGL has been subject to regular review and/or audit by the ATO in respect of its tax affairs. This is consistent with the ATO's standard approach to monitoring the taxation affairs of large companies, as set out in the ATO's "Compliance Program", published annually. AGL seeks to have an open and transparent relationship with the ATO with a view to identifying and resolving uncertain tax positions as soon as is possible.

AGL is transparent in its tax disclosures in complying with the following:

- Financial Statement reporting requirements, subject to external audit
- Detailed disclosures in annual corporate tax returns
- Annual pre-lodgement compliance reviews conducted by the ATO
- Regular GST Key Client reviews
- Annual disclosure to the ATO of "reportable tax positions"

AGL believes that the current level of transparency and tax disclosure imposed on listed companies should be adequate. The publication of corporate tax data is complicated and can easily be misinterpreted. A higher level of disclosure may lead to further misreporting in the public arena. The ATO has extensive powers to request additional information from Australian companies if necessary and this is the more appropriate channel for audit and investigation (if it is required) to ensure that companies pay the right amount of tax.

The performance and capability of the ATO

As noted above, AGL is subject to regular review by the ATO. AGL has not noticed any reduction in the level of compliance activities carried out by the ATO. Furthermore, we have not noticed any reduction in the capabilities of the ATO personnel that AGL deals with. We believe that the ATO reviews of AGL continue to be thorough and comprehensive and the ATO continues to function effectively and efficiently in AGL's view.

Yours sincerely

Paul McWilliams
Company Secretary and Head of Corporate Support Services
AGL Energy Limited

Appendix

AGL Energy Limited ("AGL")
Effective Tax Rates

Each year AGL reports both "Statutory Profit" and "Underlying Profit" and a summary of the Effective Tax Rate for both of these is presented below for the years ended 30 June 2010 to 2014. Where the Effective Tax Rate deviates significantly from the corporate tax rate of 30%, a high level summary is provided to explain the reasons for the variation.

"Statutory Profit" is prepared in accordance with the Corporations Act 2001 and the Australian Accounting Standards, which comply with the International Financial Reporting Standards.

"Underlying Profit" is the Statutory Profit adjusted for significant items (usually associated with the acquisition and disposal of investments and impairment of assets) and changes in the fair value of financial instruments. AGL believes that Underlying Profit provides a better understanding of the performance of its underlying and ongoing operations. In addition, it more closely reflects realised profits of the underlying businesses which is more akin to the calculation of taxable profits. It is also the basis on which AGL determines the amount of dividends to be paid to shareholders.

Underlying Profit

Year ended 30 June ...	2014 $M	2013 $M	2012 $M	2011 $M	2010 $M
Underlying Profit before Tax	781	825	679	619	605
Tax Expense	(219)	(240)	(197)	(188)	(176)
Underlying Profit after Tax	562	585	482	431	429
Effective Tax Rate	28.0%	29.1%	29.0%	30.4%	29.1%

The table above demonstrates that the ETR based on Underlying Profits does not vary in any significant way from the corporate tax rate of 30%. In general, the difference in the actual ETR each year from the corporate tax rate of 30% can be explained as follows:

- Adjustments in respect of non-deductible or capital expenditure expensed through the profit and loss account ("permanent" differences)
- Adjustments in respect of non-assessable items included in the profit and loss account ("permanent" differences)
- Benefits arising as a result of the R&D tax concession
- Release of tax provisions no longer required following the conclusion of ATO audit activities
- Recognition of unbooked tax losses
- Adjustments arising from the differences between the accounting and tax treatment of disposals

There is nothing abnormal or sinister in any of these variations.

Statutory Profit

Year ended 30 June ...	2014 $M	2013 $M	2012 $M	2011 $M	2010 $M
Statutory Profit before Tax	760	445	163	794	378
Tax Expense	(190)	(70)	(48)	(235)	(22)
Statutory Profit after Tax	570	375	115	559	356
Effective Tax Rate	25.0%	15.7%	29.4%	29.6%	5.8%

With regard to the Statutory reporting, the main differences between the ETR and the corporate tax rate of 30% can be explained as follows:

2010

The Statutory Tax Expense was reduced following the lodgement of an amendment request with the ATO. The amendment request was made as a result of a change in law relating to the application of the tax consolidation provisions to derivative transactions and also included adjustments to prior years.

2011

There was a further adjustment to Statutory Tax Expense in the 2011 year in relation to the changes in the tax consolidation legislation referred to above.

2012

Whilst the ETR is close to the corporate tax rate of 30%, there were two significant adjustments made in the year. Firstly, a deferred tax asset was established relating to the commencement of the application of the Petroleum Resource Rent Tax ("PRRT") to AGL's onshore petroleum activities from 1 July 2012 (reduction in Tax Expense). Secondly, there was an increase to Tax Expense resulting from an accounting write down of the carrying value of AGL's investment in Loy Yang. As there was no actual disposal of the asset, there was no corresponding tax write-off.

2013

There were a number of items which affected Statutory Tax expense in 2013:

- A number of the Upstream Gas assets were impaired for accounting purposes. As there was no actual disposal, there was no corresponding tax write-off;
- As a result of the impairments referred to above, the deferred tax asset for PRRT established in 2012 was also written off;

- An adjustment was made in respect of stamp duty incurred on the acquisition of Loy Yang;
- Following the conclusion of a tax audit relating to the treatment of unbilled income, a deferred tax liability no longer required was written off to Tax expense.

2014

The ETR for 2014 was reduced following the lodgement of an amendment request to claim additional tax depreciation arising from a prior year business acquisition. The amendment related to the current and prior years.