Committee Secretary
Senate Economics Legislation Committee
PO Box 6100
Parliament House
Canberra ACT 2600
E-mail: economics.sen@aph.gov.au

Submission on *Treasury Laws Amendment (Combating Multinational Tax Avoidance) Bill 2017* and *Diverted Profits Tax Bill 2017*
1 March 2017

The Tax Justice Network Australia (TJN-Aus) welcomes this opportunity to make submission on the *Treasury Laws Amendment (Combating Multinational Tax Avoidance) Bill 2017* and the *Diverted Profits Tax Bill 2017*. TJN-Aus welcomes the Bills, especially that they will impose a penalty tax rate of 40 per cent on profits transferred offshore through related party transactions with insufficient economic substance that reduce the tax paid on profits generated in Australia by more than 20 per cent. TJN-Aus supports both Bills being passed by the Parliament.

Schedule 1 – Diverted Profits Tax

TJN-Aus believes that in dealing with tax cheating by multinational enterprises a mix of multilateral and unilateral measures are required. This is also the view of the OECD through the Base Erosion and Profit Shifting (BEPS) project, where for example it has recommended that countries take unilateral measures to deal with issues like hybrid mismatches (where a cross-border transaction is treated as a deduction in one jurisdiction, but is not treated as taxable income in the other jurisdiction resulting in a deduction and no tax paid anywhere on the transaction). Reliance on only multilateral measures will ensure that greater levels of tax cheating will be maintained as there are foreign jurisdictions that have demonstrated that they are willing to design their tax laws to assist multinational enterprises in being able to carry out cross-border tax avoidance. Some of these jurisdictions have also been exposed as being willing to cut secret tax deals to assist multinational enterprises in tax avoidance arrangements that cheat other countries out of the tax revenue they should be able to collect.

The use of some unilateral measures is therefore essential to combat the activities of the minority of foreign jurisdictions that actively seek to facilitate cross-border tax avoidance. The Diverted Profits Tax (DPT) is necessary because of the inadequacy of the OECD BEPS Actions 8, 9 and 10 proposals on transfer pricing, and the weak proposals on Controlled Foreign Corporations (CFC) rules in Action 3. This means that multinational enterprises are still free to dodge taxes by locating activities such as ownership of Intellectual Property (IP) rights in low-tax jurisdictions, and treat operating affiliates in source countries as ‘stripped risk’ producers or distributors. The proposed DPT will help combat the "cash box" arrangements offered by the governments of Luxembourg and Switzerland, and the Dutch government provided IP management entity arrangements.

The only effective way to end many of the tax cheating strategies of multinational enterprises is to abandon the arm’s length principle for transfer pricing and treat multinational enterprises in accordance with the economic reality that they operate as unitary firms. By

continuing to accept the fiction that a multinational enterprise is a group of separate entities transacting with each other the OECD BEPS project failed to deliver on the G20 request to reform the rules so that multinational enterprises could be taxed 'where economic activities occur and value is created'. While enacting the DPT, Australia should press for such a new approach in the BEPS project, as part of the continuing work on the profit split method, and in the Digital Economy Task Force.

The UK DPT has already yielded some very public results, with Facebook (unlike Google) accepting that it has some sales in the UK, at least in relation to its large customers which have client managers in order to avoid the threat of the UK DPT. It is likely to increase tax payments by Facebook in the UK by millions of pounds.[1] The UK Government expects to raise £3.1 billion (A$6 billion) over five years from the impact of the UK DPT changing the tax behaviour of large multinational enterprises operating in the UK.[2]

Tommaso Faccio, chartered accountant and lecturer in accounting at the Nottingham University Business School in Nottingham, and Jeffery Kadet, University of Washington School of Law, note that in response to the DPT in the UK, Amazon is also reported to be in the process of establishing a taxable presence in the UK.[3] They conclude from their analysis of the UK DPT that:[4]

> *The initiation of DPT and the changes to royalty withholding announced in the 2016 U.K. budget have a major impact on the economics of profit-shifting structures that require on-the-ground sales, marketing, and other support activities in the U.K. The U.K.'s actions will be closely examined and may well be followed by numerous other countries feeling the effects of aggressive profit-shifting structures.*
>
> *If U.K.-style provisions are adopted in many other countries, multinationals worldwide should rethink the economics and risks of their profit-shifting structures, given the significant increase in local taxation that will result. Multinationals should consider unwinding their profit-shifting structures when the benefits no longer justify the risks or administrative costs and inconveniences.*

With regards to the Bills, TJN-Aus is concerned that the 20 per cent tax reduction threshold to apply the DPT may be too high. For example, a multinational enterprise with profits of $100 million in Australia would be permitted to avoid up to $20 million before being caught by the DPT. Given the threshold test does not require the ATO to take action, but allows them to, provided they have cause to believe the test of the transaction lacking economic substance applies, a lower threshold allows the ATO more ability to take action. It means if a transaction is entered into that obviously lacks economic substance, the ATO will have the option to take action. The ATO will still need to assess the amount of revenue to be recovered against the cost of the ATO taking action. Thus a threshold of 10 per cent tax reduction would seem more suitable. In addition the ATO should be able to also take action against transactions that result in a $5 million tax reduction if they lack economic substance, even if this is below the 10% threshold.

---

[1] See for example https://www.theguardian.com/technology/2016/mar/04/facebook-pay-millions-more-uk-tax-reports; and http://www.irishexaminer.com/examviral/technology-and-gaming/qa-everything-you-need-to-know-about-facebooks-decision-to-pay-more-tax-in-the-uk-385649.html

[2] http://www.irishexaminer.com/examviral/technology-and-gaming/qa-everything-you-need-to-know-about-facebooks-decision-to-pay-more-tax-in-the-uk-385649.html

[3] Tommaso Faccio and Jeffery Kadet, "Will Bringing Sales Onshore in the U.K. Lead to Higher Taxes?", *Tax Notes International* **82(7)**, 16 May 2016, p. 684.

[4] Tommaso Faccio and Jeffery Kadet, "Will Bringing Sales Onshore in the U.K. Lead to Higher Taxes?", *Tax Notes International* **82(7)**, 16 May 2016, p. 685.

TJN-Aus supports that the DPT will apply where it is reasonable to conclude based on the information available at the time to the ATO that the arrangement was designed (as one of its purposes) to secure a tax reduction for the relevant multinational enterprise (MNE) or for other taxpayers.

TJN-Aus supports that the ATO be given more options to reconstruct the alternative arrangement on which to assess the diverted profits where a related party transaction is assessed to be artificial or contrived.

TJN-Aus supports that the DPT will impose a liability when an assessment is issued by the ATO (so it will not operate on a self-assessment basis) and that it will require upfront payment, which can only be adjusted following the successful review of the assessment. We also support that the DPT will put the onus on taxpayers to provide relevant and timely information on offshore related party transactions to the ATO to prove why the DPT should not apply.

TJN-Aus supports the DPT starting from income years commencing on or after 1 July 2017 and that it will apply whether or not a relevant transaction (or series of transactions) was entered into before that date.

TJN-Aus would prefer that the DPT applied to wider group of multinational enterprises, so would prefer a lower annual income threshold of $200 million. However, TJN-Aus accepts that at this point in time the measure be targeted to very large multinational enterprises with annual global income of $1 billion or more or an entity that is a member of a group of entities, consolidated for accounting purposes, which has annual global income of $1 billion or more.

TJN-Aus believes that the de minimis threshold of $25 million of Australian turnover for the DPT to apply is on the high side, but acknowledges that initially the DPT should be targeted to larger entities that may be engaged in tax avoidance in Australia. TJN-Aus accepts that the de minimis threshold aligns with a number of existing thresholds. However, TJN-Aus notes the UK DPT has no de minimis.[5]

TJN-Aus supports that where a significant global entity has multiple related Australian entities, the $25 million de minimis will be calculated based on the total Australian turnover of the entities.

TJN-Aus welcomes that the $25 million turnover test will not apply if it is reasonable to conclude that the relevant taxpayer, or another entity that is a significant global entity because it is a member of the same global group as the relevant taxpayer, has artificially booked turnover outside Australia.

TJN-Aus supports that an arrangement with a related party be subject to the DPT if the transaction has insufficient economic substance. TJN-Aus agrees that the determination of whether there is insufficient economic substance be based upon whether it is reasonable to conclude based on the information available at the time to the ATO that the transaction(s) was designed to secure the tax reduction.

TJN-Aus agrees that in determining the increased foreign tax liability it will be based on the income taxes actually paid in relation to the scheme. This is important as some foreign jurisdictions have demonstrated that they are willing to actively design their tax laws and enter into special tax arrangements to facilitate tax avoidance by multinational enterprises.

[5] Lydia Challen, Mark Middleditch and Ka Sen Wong, 'Diverted Profits Tax – the UK experience', 15 September 2016 http://www.allenovery.com/SiteCollectionDocuments/DPT%20Slides.pdf

To allow for exemptions in determining the reduction in the tax liability will encourage such jurisdictions to attract multinational corporate tax avoiders by specifically designing their tax laws or cutting special tax deals to exploit any exemption provided.

TJN-Aus agrees that the DPT due and payable should not be reduced by the amount of tax paid in a foreign jurisdiction on the diverted profits, consistent with the application of penalties under Australia's existing transfer pricing rules.

We also agree that the DPT assessment include an interest charge calculated by reference to the period from the date any amount would have been payable on the relevant income tax assessment to the issue of the provisional DPT assessment.

TJN-Aus agrees that the DPT should not be deductible or creditable for income tax (or Petroleum Resource Rent Tax) purposes.

TJN-Aus believes that taxpayers should be required to disclose up front if they may have transactions that could give rise to a DPT liability (as is the case with the UK DPT)[6], with significant penalties for failing to disclose such a risk. Such a requirement would reduce the enforcement burden on the ATO, as it will reduce the level of resources needed by the ATO to find the cases where the DPT should apply. However, any requirement to disclose transactions that could give rise to a DPT liability should not replace the ATO carrying out its own thorough investigations to detect arrangements that have not been disclosed or even accept the version of self-disclosure by the multinational enterprise without conducting its own verification of the facts.

TJN-Aus agrees that the DPT can be applied up to seven years after the taxpayer has lodged their income tax return for the relevant year, consistent with the current review period for transfer pricing matters.

TJN-Aus supports that the taxpayer will have 21 days to pay the amount made in the assessment of the DPT.

TJN-Aus agrees that the ATO be given 12 months to review the final DPT assessment, during which time the taxpayer may provide information to the ATO to support an amendment to the DPT assessment, consistent with the UK DPT. TJN-Aus supports the Commissioner being able to seek extension of the review period through the Federal Court where the Commissioner is of the view that further time is required to obtain information and documents.

TJN-Aus supports that, during the review period, the ATO may issue a supplementary DPT assessment to increase the amount of DPT payable up to 30 days prior to the end of the review period.

At the end of the review period the taxpayer should be given 30 days to lodge an appeal through the court process as was the case in the exposure draft of the Bill, not the 60 days that are now in the Bill before the Parliament. TJN-Aus agrees the Federal Court be restricted to considering only evidence that was provided to the Commissioner before the end of the review period with the limited exceptions outlined in the Bill.

[6] Lydia Challen, Mark Middleditch and Ka Sen Wong, 'Diverted Profits Tax – the UK experience', 15 September 2016 http://www.allenovery.com/SiteCollectionDocuments/DPT%20Slides.pdf

Schedule 2 – Increasing penalties for significant global entities

Given the significant sums of money to be gained by large multinational enterprises (MNEs) that engage in tax avoidance, to deter such behaviour there is a need to ensure that the penalties are adequate to remove the profit from the crime, as well as the need to create a significant apprehension that the MNE and its key management personnel involved in the tax avoidance will be caught so the sanction will apply. Criminology literature finds that perceived certainty of punishment is associated with reduced intended offending.[7] Thus, the government needs to ensure that the additional penalties are backed up by a properly resourced Australian Taxation Office that is capable to making MNEs tempted to engage in tax avoidance believe that they will be caught and when caught the penalty will be significantly greater than the potential profit that could be gained through the tax avoidance.

As noted in the explanatory memorandum, the penalty for 'failure to lodge on time' has already been varied depending on the size of the business that fails to lodge on time, in recognition that the penalty must be proportionate to the size of the business if it is to act as any incentive to make the business lodge on time. The *Treasury Laws Amendment (Combating Multinational Tax Avoidance) Bill 2017* is simply extending the existing principle to make it applicable to 'significant global entities'

TJN-Aus agrees that the penalty for failing to lodge a return, notice, statement, Country-by-Country report or other approved form to the Commissioner on time be increased to at least a maximum of $450,000 for significant global entities, which will only apply where the lodgement is more than 16 weeks late. Given the resources that significant global entities usually have at their disposal, they have less excuse not to lodge accurate documents to the Commissioner of Taxation on time than smaller businesses do (although in our view all businesses and individuals should lodge documents required by the Commissioner of Taxation on time, unless there are exception circumstances that have been discussed with the Commissioner).

TJN-Aus supports the doubling of administrative penalties for significant global entities relating to statements and failing to give documents necessary to determine tax-related liabilities. However, TJN-Aus questions if this increase in penalty is sufficient given the financial resources of the significant global entity and if a higher multiplier would not be more appropriate given the possible tax revenue at stake, such as increasing the penalties five-fold. A higher multiplier seems more appropriate, given the Commissioner has the ability to remit higher penalties based on the circumstances of the corporation in question.

TJN-Aus supports that the Bill will allow the Commissioner of Taxation to apply an administrative penalty where a significant global entity fails to provide a general purpose financial statement in the approved form to the Commissioner of Taxation or ASIC.

Dr Mark Zirnsak
Secretariat
Tax Justice Network Australia
c/- 130 Little Collins Street
Melbourne, Victoria, 3000
Phone:
E-mail:

[7] Daniel S Nagin, 'Deterrence in the Twenty-First Century', *Crime and Justice* Vol. 42, No. 1, (August 2013), 201.

Background on the Tax Justice Network Australia

The Tax Justice Network Australia (TJN-Aus) is the Australian branch of the Tax Justice Network (TJN) and the Global Alliance for Tax Justice. TJN is an independent organisation launched in the British Houses of Parliament in March 2003. It is dedicated to high-level research, analysis and advocacy in the field of tax and regulation. TJN works to map, analyse and explain the role of taxation and the harmful impacts of tax evasion, tax avoidance, tax competition and tax havens. TJN's objective is to encourage reform at the global and national levels.

The Tax Justice Network aims to:

(a) promote sustainable finance for development;
(b) promote international co-operation on tax regulation and tax related crimes;
(c) oppose tax havens;
(d) promote progressive and equitable taxation;
(e) promote corporate responsibility and accountability; and
(f) promote tax compliance and a culture of responsibility.

In Australia the current members of TJN-Aus are:

- ActionAid Australia
- Aid/Watch
- Anglican Overseas Aid
- Australian Council for International Development (ACFID)
- Australian Council of Trade Unions (ACTU)
- Australian Education Union
- Australian Services Union
- Baptist World Aid
- Caritas Australia
- Columban Mission Institute, Centre for Peace Ecology and Justice
- Community and Public Service Union
- Friends of the Earth
- GetUp!
- Global Poverty Project
- Greenpeace Australia Pacific
- International Transport Workers Federation
- Jubilee Australia
- Maritime Union of Australia
- National Tertiary Education Union
- New South Wales Nurses and Midwives' Association
- Oaktree Foundation
- Oxfam Australia
- Save the Children Australia
- SEARCH Foundation
- SJ around the Bay
- Social Policy Connections
- SumOfUs
- Synod of Victoria and Tasmania, Uniting Church in Australia
- TEAR Australia
- Union Aid Abroad – APHEDA
- UnitedVoice
- UnitingWorld
- UnitingJustice
- Victorian Trades Hall Council
- World Vision Australia