The Senate

Economics References Committee

Corporate tax avoidance

Part I
You cannot tax what you cannot see

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Senate Economics References Committee

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Executive Summary

This interim report summarises the findings of the Senate Inquiry into corporate tax avoidance and aggressive minimisation, after holding five public hearings and receiving more than one hundred submissions. Given both the public interest and new issues that have been raised over the course of the inquiry, it will continue through the latter half of the year with a provisional final reporting date of 30 November 2015.

This interim report makes 17 recommendations over four areas:

- evidence of tax avoidance and aggressive minimisation;
- multilateral efforts to combat tax avoidance and aggressive minimisation;
- potential areas of unilateral action to protect Australia's revenue base; and
- the capacity of Australian government agencies to collect corporate taxes.

It is expected that the final report will focus primarily on transfer pricing and profit shifting, with a secondary focus on:

- excessive debt loading;
- foreign companies avoiding permanent establishment in Australia;
- the use of tax havens;
- exemptions from general purpose accounting; and
- the role of private accounting firms in tax avoidance.

Background to the interim report

The Senate Inquiry into Corporate Tax avoidance was referred to the Economics References Committee on Thursday 2 October 2014.

It was prompted by the publication a week earlier of the Tax Justice Network Australia (TJN) and United Voice report, *Who Pays for Our Common Wealth: the Tax practices of the ASX 200*, on Friday 29 September 2014.

The Australian Taxation Office (ATO) appeared with Treasury Revenue Group at Senate Additional Estimates a few weeks later, on Wednesday 22 October 2014, where the TJN report was the subject of intense scrutiny and discussion.

Tax avoidance was part of G20 conference discussions in Brisbane on 15–16 November 2014, specifically the development of the Base Erosion and Profit Shifting (BEPS) Action Plan.

When the inquiry met for its first hearing in Sydney on Wednesday 8 April 2015, there was recognition among both senators and witnesses that this issue was complex.

But when the 'tech majors'—Apple, Google and Microsoft—appeared before the committee, it became clear just how simple the principles of tax minimisation are.

Regardless of the political preferences of the senators on the committee, all can be confident that they have helped the public understand how the principles of operating an incorporated entity in Australia have changed.

In the past, a multinational company with a branch in Australia had a local board that was tasked with maximizing profits. But increasingly, Australian operations of multinational companies are becoming agents, shifting revenue offshore specifically to minimize Australian profits. This was evident throughout the inquiry.

The American headquartered technology companies run their Australian operations as marketing and distribution companies and shift revenue earned in Australia to other jurisdictions. The legitimacy of these transfers will continue to be a focus of the inquiry.

Australia's largest tax payer, BHP Billiton, found itself in the awkward position of being unable to inform the committee at a public hearing about the activities of its marketing hub operations in Singapore, only to read in newspapers that these were a matter of public record in the city state.

The pharmaceutical industry appears to set drug prices in Australia based on maintaining a small but astonishingly consistent profit margin of 3 to 4 per cent, while paying much larger revenues to parent companies overseas.

Commissioner of Taxation, Mr Chris Jordan, has used the inquiry to effectively promote the work of the ATO in leading efforts to increase global cooperation to combat tax avoidance.

The ATO also aided the committee by suggesting an alternative to the TJN's model for calculating effective tax rates, which is included as an appendix to this interim report.

The chair of the committee wishes to acknowledge Senator Christine Milne's contribution to the work of this committee during its inquiry into corporate tax avoidance and aggressive minimisation. It was on her initiative that the matter was referred to the committee and the committee wishes to record its sincere thanks for her unwavering support throughout this inquiry.

Recommendations

Evidence of tax avoidance and aggressive minimisation

Recommendation 1

3.68 The committee recommends that the Australian Government work with governments of countries with significant marketing hub activity to improve the transparency of information regarding taxation, monetary flows and inter-related party dealings.

Multilateral efforts to combat tax avoidance and aggressive minimisation

Recommendation 2

4.43 The committee recommends that the Australian Government continue to take a leadership role in finalising and implementing the efforts of the OECD in addressing problems associated with base erosion and profit shifting. However, the committee also considers that international collaboration should not prevent the Australian Government from taking unilateral action.

Potential areas of unilateral action to protect Australia's revenue base

Recommendation 3

5.31 The committee recommends that a mandatory tax reporting code be implemented as soon as practicable but no later than the current timeframe for the proposed voluntary public transparency code. Any Australian corporation or subsidiary of a multinational corporation with an annual turnover above an agreed figure would be required to publicly report financial information on revenue, expenses, tax paid and tax benefits/deductions from specific government incentives, such as fuel rebates and research and development offsets.

Recommendation 4

5.32 The committee recommends maintaining existing tax transparency laws which apply to both private and public companies.

Recommendation 5

5.39 The committee recommends establishing a public register of tax avoidance settlements reached with the ATO where the value of that settlement is over an agreed threshold.

Recommendation 6

5.40 The committee recommends that the government consider publishing excerpts from the Country-by-Country reports, and suggests that the government consider implementing Country-by-Country reporting based closely on the European Union's standards.

Recommendation 7

5.45 The committee recommends that the ATO, in conjunction with Treasury and other relevant agencies, provide an annual public report on aggressive tax minimisation and avoidance activities to be tabled in Parliament. This report could include estimations of forgone revenue, evaluate the effectiveness of policy and propose potential changes.

Recommendation 8

5.85 The committee recommends that the Australian Government tender process require all companies to state their country of domicile for tax purposes.

Recommendation 9

5.86 The committee recommends mandatory notification by agencies to the relevant portfolio Minister when contracts with a dollar value above an agreed threshold are awarded to companies domiciled offshore for tax purposes.

The capacity of Australian government agencies to collect corporate taxes

Recommendation 10

6.25 The committee recommends an independent audit of ATO resourcing, funding and staffing.

Recommendation 11

6.26 The committee recommends the ATO report to parliament, at least annually on:

- the number of audits or disputes launched concerning multinational corporations;
- the number of cases settled with multinational corporations;
- the number of successful legal proceedings concluded against multinational corporations; and
- the staff resources allocated to tax compliance of multinational corporations.

Recommendation 12

6.71 The committee recommends that taxation legislation be amended so that non-reporting entities are required to disclose related party information in financial reports under the Corporations Act if notified to do so by the ATO.

Recommendation 13

6.72 The committee recommends that the concept of 'grandfathered large proprietary companies' be removed from the Corporations Act, and these companies be required to lodge financial reports with the Australian Securities and Investments Commission (ASIC).

Recommendation 14

6.73 The committee recommends that all proprietary companies are required to review and confirm their size with ASIC annually.

Recommendation 15

6.74 The committee recommends that the confidentiality provisions in section 127 of the ASIC Act be amended to allow ASIC to share information with the ATO without having to notify the affected person.

Recommendation 16

6.75 The committee recommends that people who propose to become directors of companies be required to provide evidence of their identity to the ASIC.

Recommendation 17

6.76 The committee recommends that ASIC amend Class Order 98/98 so that a company is not eligible for financial reporting relief, where the ATO notifies the company and ASIC that the relief does not apply to that company.

Chapter 1
Background to the inquiry

1.1 On 2 October 2014, the Senate referred the matter of corporate tax avoidance and aggressive minimisation to the Economics References Committee for inquiry and report by the first sitting day of June 2015.[1] On 16 June 2015, the reporting date for the inquiry was extended to 13 August 2015. On 10 August 2015, the reporting date for the inquiry was further extended to 30 November 2015.

1.2 The terms of reference for the inquiry are:

> Tax avoidance and aggressive minimisation by corporations registered in Australia and multinational corporations operating in Australia, with specific reference to:
>
> (a) the adequacy of Australia's current laws;
>
> (b) any need for greater transparency to deter tax avoidance and provide assurance that all companies are complying fully with Australia's tax laws;
>
> (c) the broader economic impacts of this behaviour, beyond the direct effect on government revenue;
>
> (d) the opportunities to collaborate internationally and/or act unilaterally to address the problem;
>
> (e) the performance and capability of the Australian Taxation Office (ATO) to investigate and launch litigation, in the wake of drastic budget cuts to staffing numbers;
>
> (f) the role and performance of the Australian Securities and Investments Commission in working with corporations and supporting the ATO to protect public revenue;
>
> (g) any relevant recommendations or issues arising from the Government's White Paper process on the 'Reform of Australia's Tax System'; and
>
> (h) any other related matters.[2]

1.3 Given the broad scope of the inquiry and the variety of aspects to consider, the committee resolved to release an interim report on the evidence that was received following the initial request for submissions and presented at the hearings in April 2015.

1.4 The committee is continuing to investigate a number of matters in relation to the operations and structure of multinationals that were not part of the initial consultation process. A final report will be released following the conclusion of these investigations.

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1 *Journals of the Senate*, No. 59, 2 October 2014, p. 1588.

2 *Journals of the Senate*, No. 59, 2 October 2014, p. 1588.

Conduct of inquiry

1.5 The committee advertised the inquiry on its website and in the *Australian*. The committee also wrote directly to government agencies, large corporations based in Australia and multinationals operating in Australia, industry groups and associations, academics and other interested parties drawing attention to the inquiry and inviting them to make submissions.

Submissions and public hearings

1.6 The committee received 121 submissions, including 3 confidential submissions. The submissions and questions on notice are listed at Appendix 1.

1.7 To date, the committee has held six public hearings:

- 8 April 2015 in Sydney;
- 9 April 2015 in Canberra;
- 10 April 2015 in Melbourne;
- 22 April 2015 in Sydney;
- 1 July 2015 in Sydney; and
- 4 August 2015 in Melbourne.

1.8 A list of witnesses is provided at Appendix 2. References to the Committee Hansard are to the Proof Hansard and page numbers may vary between the Proof and Final Hansard transcripts.

1.9 The committee thanks all the individuals and organisations who assisted with the inquiry, especially those who made written submissions and appeared at hearings.

Background to inquiry

1.10 The matter of corporate tax was referred to the committee because of widespread concerns about the nature and prevalence of tax avoidance and aggressive tax minimisation among large Australian corporations and multinational enterprises operating in Australia.

1.11 Internationally, the Organisation for Economic Co-operation and Development (OECD) is concerned that many multinational companies are legally able to plan their tax affairs to reduce significantly, if not eliminate, their tax liabilities. It understands that:

> Global solutions are needed to ensure that tax systems do not unduly favour multinational enterprises, leaving citizens and small business with bigger tax bills.[3]

1.12 In response, the Group of 20 (G20) and OECD, together with other willing countries, have been developing a series of measures which aim to put an end to

3 *OECD urges stronger international co-operation on corporate tax*, 12 February 2013, http://www.oecd.org/ctp/oecd-urges-stronger-international-co-operation-on-corporate-tax.htm (accessed 30 July 2015).

aggressive tax planning and fix loopholes that currently exist in the international tax framework.[4]

1.13 It has also been recognised domestically that there are opportunities within the tax system for multinationals to minimise the tax burden in Australia. In an address to the World Economic Forum, the Prime Minster identified the need for action:

> A more global economy with stronger cross-border investment eventually helps everyone because it generates more wealth and ultimately creates more jobs.
>
> Of course, money's tendency to flow to where taxes are lowest is a powerful incentive for all countries to keep taxes down.
>
> One of the side effects of globalisation is more ability to take advantage of different country's tax regimes.
>
> Different national tax arrangements have not always kept up with the rise of services and the pervasiveness of digital technologies.
>
> So, the G20 will continue to tackle businesses artificially generating profits to chase tax opportunities rather than market ones.
>
> The essential principle is that you should normally pay tax in the country where you've earned the revenue.[5]

1.14 While successive governments have sought to address the deficiencies in the tax system, the matter was again brought to the fore in October 2014 by the Tax Justice Network Australia. The report, *Who Pays for Our Common Wealth?*, asserted that many of the largest public corporations (as listed on the ASX 200) do not pay their 'fair share' of corporate tax and have subsidiaries operating in jurisdictions considered to be 'tax havens'.[6]

1.15 The Tax Justice Network Australia report reignited the corporate tax debate and led to a number of media reports exploring and highlighting the extent to which some Australian companies and multinationals operating in Australia were using aggressive tax planning to reduce their Australian tax obligations.[7] This further contributed to concerns within the community that large corporations were not paying their 'fair share' of tax.

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4 *Committee Hansard*, 9 April 2015, p. 59.

5 The Honourable Tony Abbott MP, *This Year's G20: Getting the Fundamentals Right*, Address to the World Economic Forum, Davos Switzerland, 23 January 2014.

6 Tax Justice Network—Australia, *Who Pays for Our Common Wealth*, October 2014.

7 See, for example, Health Aston and Georgia Wilkins, 'ASX 200 company tax avoidance bleeds Commonwealth coffers of billions a year, report finds', *Sydney Morning Herald*, 29 September 2014; and 'Tax Justice Network report reveals tax burden shifting from companies to ordinary taxpayers', www.news.com.au, 29 September 2014.

Defining tax avoidance and aggressive minimisation

1.16 Noting that definition of certain terms may differ, it is necessary to define tax minimisation, tax avoidance and tax evasion for the purposes of this report. In the words of Mr Martin Lock:

> Corporate tax avoidance is difficult to define. However, without defining it, it can't be identified, measured or addressed.[8]

1.17 Tax minimisation, tax avoidance and tax evasion can be considered along a spectrum of activity, where tax minimisation and tax evasion sit on either end with a large 'grey' area in between representing aggressive tax minimisation and tax avoidance.

1.18 Tax minimisation, or tax planning, is a legal activity permitted under the income tax framework which allows corporations to reduce their tax obligations. Tax planning is legitimate when it is done within the letter of the law.

1.19 By contrast, tax evasion is an illegal activity whereby corporations deliberately and intentionally mislead tax authorities in order to reduce tax obligations.

1.20 Aggressive tax minimisation, or aggressive tax planning, encompasses schemes that push the boundaries of what is considered to be acceptable. For example, aggressive schemes may include claiming excessive deductions (such as interest related to debt loading) or complex financing arrangements that may facilitate avoidance of tax obligations.

1.21 Similarly, tax avoidance refers to activities that sit on the edge of being legal and require investigation (and possibly litigation) to determine whether they are within the law. Australia has general anti-avoidance rules (GAAR) which seek to impose tax obligations on tax avoidance schemes that are wholly or predominantly undertaken to receive a tax benefit.[9]

1.22 Indeed, the legality of this grey area is somewhat indeterminate as some schemes associated with aggressive minimisation and avoidance are yet to be investigated, potentially challenged and ruled on by tax authorities and courts. Such considerations about legality are further complicated by the fact that most schemes are unique and tailored to individual business circumstances. As such, a dedicated evaluation process by tax authorities is often required to determine if aggressive minimisation and avoidance schemes are legitimate.

Scope of this inquiry

1.23 The committee appreciates that Australia's corporate tax system is complex and it often takes many years to become an experienced practitioner. As such, it is

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8 *Submission 56*, p. 3.

9 General anti-avoidance provisions are outlined in Part IVA of the *Income Tax Assessment Act 1936*.

beyond the scope of this inquiry to consider specific technicalities of the corporate tax regime and/or its interpretation.

1.24 That said, there appears to be a number of aspects of Australia's corporate tax system that allows some corporations to reduce or even eliminate their Australian tax obligations in a way that was not intended by the parliament when the law was enacted.

1.25 Reflecting these concerns and multi-dimensional nature of corporate tax concerns, this inquiry explores:

- the importance of corporate income tax to Australia's revenue base;
- the effect of tax avoidance and minimisation activities on the integrity of the tax system, and society more broadly;
- the challenges facing the sustainability of the corporate income tax base;
- opportunities to strengthen the integrity of the corporate tax system and address risks to its sustainability;
- progress on implementing actions identified by the G20 initiative on BEPS and associated plans;
- the potential for Australia to take unilateral action to address risks to the corporate income tax base; and
- the efficiency and effectiveness of the Australian Taxation Office to identify and enforce attempts to thwart corporate income tax responsibilities.

1.26 The committee notes that a number of stakeholders commented on the tax avoidance activities of Australian multinationals in the context of developing countries.[10] However, it considers that this issue was outside the scope of the inquiry's terms of reference which was looking at tax avoidance in Australia. Where appropriate, this issue may be within scope of the inquiry into foreign bribery.

Structure of this report

1.27 This interim report comprises six chapters.

- Chapter 1—provides background to the inquiry.
- Chapter 2—provides a broad overview of corporate income tax in Australia.
- Chapter 3—identifies various risks and challenges to the integrity of the corporate income tax base.
- Chapter 4—examines the work of the OECD to develop a coordinated approach to address issues associated with base erosion and profit shifting.
- Chapter 5—explores opportunities for Australia to take unilateral action to close some existing problems with the corporate tax regime that are outside

10 See, for example, Publish What You Pay, *Submission 30*; ActionAid Australia, *Submission 67*; and Uniting Church of Australia, Synod of Victoria and Tasmania, *Submission 74.*

the OECD remit and considers unilateral options in circumstances where the OECD work does lead to the intended outcome.

- Chapter 6—reviews the performance and capabilities of the ATO and the role of the Australian Securities and Investments Commission (ASIC) in sharing information relevant to identifying corporate tax avoidance.

Chapter 2

Overview of Australia's corporate tax system

2.1 This chapter provides an overview of Australia's corporate tax system and its importance as a source of public revenue. In particular, this chapter:

- provides an introduction to Australia's corporate tax system;
- considers the international context; and
- explores the broad impacts associated with tax avoidance and aggressive minimisation.

Introduction to Australia's corporate income tax system

2.2 Australia's taxation system is extremely complex and issues relating to corporate tax are no different. As such, the information presented in this section provides a brief overview of how the corporate income tax system operates—noting there are many highly technical rules and interpretations that affect businesses and investment decisions, and the amount of corporate income tax paid.

2.3 While corporations pay a variety of taxes and levies (including payroll tax, GST and royalties) to different levels of government, the potential for tax avoidance and aggressive minimisation appears to be greatest in the area of corporate income tax. That said, there are also competition concerns when corporations may have different costs structures because of the taxes levied on them by virtue of operating from other jurisdictions. These issues are explored in chapter 5.

Corporate income tax is levied on assessable income

2.4 Australian corporations that are considered permanent establishments are required to pay corporate income tax on assessable income. The general rate of taxation is 30 per cent but there are some variations for a small number of specific company types. Assessable income is defined as total revenue less allowable deductions that are associated with the costs of doing business.

2.5 Corporations are entitled to deduct various expenses relating to their business operations. Allowable deductions include:

- costs incurred in supplying goods and services, including employee costs;
- interest payments on borrowed money;
- depreciation and amortisation of capital goods; and
- research and development expenses.

2.6 Australia has a broad-based company income tax regime which seeks to tax assessable income on a territorial basis—that is, in the jurisdiction where it is sourced. If assessable income is derived from activities within Australia, then that income is taxed according to the Australian company tax regime.[1]

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1 Treasury, *Risks to Australia's Corporate Tax Base*, Scoping Paper, July 2013, p. 11.

2.7 Where assessable income is derived from activities outside Australia, that income is generally exempt from corporate income tax provided that the income was 'actively' earned.[2] In certain circumstances, however, corporations may be required to pay 'top-up' tax to Australia on repatriated earnings as required by Controlled Foreign Company rules. For example, BHP Billiton has paid 'top-up' tax to Australia on profits repatriated from its Singapore marketing hub.[3]

Certain types of corporations are exempt from paying income tax

2.8 While most corporations undertaking business activities are required to pay corporate income tax, certain types of corporate entities are not liable.

2.9 Partnerships and trusts are not required to pay corporate tax provided their assessable income is distributed to unit holders. Unit holders are then required to pay either corporate tax (in the case of a company) or personal income tax (in the case of individuals) on distributed income on a flow-through basis.

2.10 Property trusts, such as Real Estate Investment Trusts (REITs), do not pay corporate income tax on passive rental income but distribute this to investors who pay tax at their own individual tax rate.[4] In Australia, stapled securities are used to split the passive and active income earning activities of property investments. Active income from trading activities, such as funds management and property development, are subject to corporate income tax.[5]

2.11 Other types of incorporated entities are also exempt from paying income tax, such as certain non-profit organisations and charities.

Breakdown of corporate tax in Australia

Large companies pay the majority of corporate income tax

2.12 Over 850,000 companies lodged a tax return in 2012–13 and paid $66.9 billion in company income tax.[6] This represented about 19 per cent of total federal tax receipts.[7]

2.13 Corporate tax revenue is highly concentrated with the majority of corporate tax paid by only a relatively small number of companies. For example, large companies with turnover of greater than $250 million account for over 60 per cent of

2 By contrast, individual and 'passive' business income is taxed on a worldwide basis and, as such, is levied on total assessable income regardless of the jurisdiction in which it is sourced. The Board of Taxation, *Review of Debt and Equity Tax Rules: Discussion Paper*, March 2014.

3 *Answer to Question on Notice No. 14*, p. 1.

4 Property Council of Australia, *Submission 18*, p. 5.

5 Property Council of Australia, *Submission 18*, p. 5.

6 ATO, *Submission 48*, pp. 6–7.

7 Australian Government, *Re:think—Tax Discussion Paper*, March 2015, p. 76.

net corporate income tax but represent less than 0.2 per cent of the total number of corporate entities that lodged a tax return.[8]

Table 2.1: Corporate tax characteristics by entity size, 2012–13[9]

	Annual Turnover	Number	Proportion of corporations	Net tax ($b)	Proportion of net tax
Large	Greater than $250 million	1,091	0.1	38.7	61.1
Medium	$10 million to $250 million	16,031	1.9	11.1	17.5
Small	$2 million to $10 million	56,136	6.5	6.2	9.8
Micro	$1 to $2 million	670,564	77.6	7.2	11.4
Loss/Nil	Less than $1	120,384	13.9	0.1	0.2
Total			**100**	**63.3[10]**	**100**

2.14 The ATO noted that 69 higher consequence (or key) taxpayers, which typically have a turnover of more than $5 billion annually, represent 42 per cent of the entire corporate tax base.[11]

2.15 In terms of industry contributions, the financial services and mining industries accounted for over half of all corporate tax revenue in 2012–13.[12] However, given the cyclical nature of the mining industry and recent falls in commodity prices, it is unlikely that this sector will continue to contribute income tax revenue to the same level in the short term.

2.16 Losses can also have a significant effect on income tax revenue as prior year losses can be offset against current year income. In 2012–13, 148,738 companies used $18.1 billion in prior year tax losses to offset income tax liabilities and the balance of carried forward losses for all companies was $264.3 billion.[13]

8 ATO, *Submission 48*, pp. 5–6.

9 ATO, *Submission 48*, p. 5.

10 According to the ATO, net income tax payable in 2012–13 was $63.3 billion whereas company income tax collections were $66.9 billion. Tax payable represents the tax obligation for the year (calculated after the tax return is completed) whereas tax collected represents the tax collected during the year (PAYG instalments, wash-up payments and refunds).

11 *Committee Hansard*, 8 April 2015, p. 19.

12 ATO, *Submission 48*, p. 7.

13 ATO, *Submission 48*, p. 10.

Private companies are also important contributors

2.17 Private companies contributed $22 billion, or about a third, of the total corporate tax paid in 2012–13. Almost 70 per cent of the tax paid by this group was from private companies with turnover greater than $2 million.[14]

2.18 There are 147,000 private companies associated with 220,000 private groups linked to 119,000 wealthy individuals, defined as resident individuals who, together with their business associates, control more than $5 million in net wealth.[15]

2.19 Wealthy individuals and their private groups often have complex arrangements and utilise flow-through entities, such as trusts and partnerships in addition to companies.[16]

Corporate income tax is an important contributor to Commonwealth revenue

2.20 Corporate income tax is an important part of Australia's tax base and is the second largest contributor to tax revenue after personal income tax.

2.21 Australia's company tax revenue as a proportion of GDP at 5.2 per cent is higher than the OECD average of 2.9 per cent.[17] This relatively high proportion reflects a number of factors including:

- Levels of incorporation differ across countries, and the classification of income companies may differ.
- Levels of corporate sector profitability differ across countries.
- Incentives for domestically-owned companies to pay tax in Australia in order to pay fully franked dividends under the imputation system.
- Australia's company income tax regime is relatively broad-based, with limited concessional write-off arrangements compared to many OECD countries.[18]

2.22 In addition, Australia does not levy social security taxes, which are a large source of direct taxation revenue for a significant number of OECD countries.[19]

Corporate income tax and personal income tax are inter-related

2.23 Australia's system of dividend imputation effectively links the corporate and personal income tax systems, whereby taxes paid by companies are distributed to shareholders via franked dividends. Franked dividends have tax credits attached that allow Australian shareholders to offset their income tax. By comparison, trust income

14 ATO, *Submission 48*, p. 12.

15 ATO, *Submission 48*, p. 12.

16 ATO, *Submission 48*, p. 12.

17 Australian Government, *Re:think—Tax Discussion Paper*, March 2015, p. 75.

18 Australia's Future Tax System Review Panel, *Australia's Future Tax System*, 2 May 2010, p. 159.

19 Treasury, *Pocket guide to the Australian taxation system 2012–13*, 2013, p. 3.

distributed on a flow-through basis is not franked and does not have tax credits attached.

2.24 Dividend imputation systems are rare internationally with most countries undertaking some form of 'double taxation', whereby corporate income taxes are paid on profits and personal income taxes are paid on dividends (with some countries levying lower personal tax rates on dividends compared to earned income). Australia, New Zealand, Chile and Mexico are the only OECD countries to operate a dividend imputation system.[20]

2.25 The majority of Commonwealth revenue in Australia is sourced from personal and corporate income taxes, collectively representing over 70 per cent of total revenue in 2012–13.[21] As a result, Commonwealth revenue is highly susceptible to base erosion if the integrity of the income tax regime is compromised.

International comparisons of corporate income tax

2.26 Australia's statutory corporate tax rate of 30 per cent is roughly equal to the average corporate tax rate of the nations with the 10 largest economies.[22] However, it is higher than both the OECD average (25.3 per cent) and other small to medium OECD countries (23.9 per cent).[23] Based on corporate tax rates alone, Australia is at a comparative disadvantage in attracting foreign investment.

2.27 This disadvantage is exacerbated where countries choose competitive corporate income tax policies to attract economic activity. For example, some large multinational companies have established entities in Singapore, Hong Kong or Ireland where statutory corporate income tax rates are 17, 16.5 and 12.5 per cent respectively.

2.28 Some countries have preferential agreements with certain corporate entities to reduce the effective rate of tax paid. The committee heard that Singapore has had programs in place since 1967 to encourage multinational corporations to set up and operate activity hubs.[24] As such, many large corporations have negotiated effective tax rates much lower than the statutory rate. For example, BHP Billiton effectively pays no income tax on profits from its Singapore marketing operations.[25]

2.29 Submissions and previous reviews have highlighted that proposed changes to reduce the rate of corporate income tax may not substantially alter the tax

20 Australian Government, *Re:think—Tax Discussion Paper*, March 2015, p 85.

21 Australian Government, *Re:think—Tax Discussion Paper*, March 2015, p. 21.

22 Australian Government, *Re:think—Tax Discussion Paper*, March 2015, p. 75.

23 OECD, *OECD Tax Database*, http://www.oecd.org/tax/tax-policy/tax-database.htm (accessed 19 March 2015). Data presented is for 2014 and reflects combined state and federal corporate income tax rates (where levied).

24 Mr Grant Wardell-Johnson, KPMG, *Committee Hansard*, 9 April 2015, p. 9.

25 BHP Billiton, *Answer to Question on Notice No. 14*, 24 April 2015, p. 1.

competitiveness of Australia relative to other countries where multinational corporations may choose to base their operations.[26]

International aspects of corporate taxation

2.30 Developments in technology and the increasing importance of trade in the operations of multinational companies have resulted in an international taxation system that is outdated and provides opportunities for multinational corporations to exploit loopholes and discrepancies between jurisdictions.

2.31 The ATO notes that the rapid pace of globalisation has seen the Australian economy become increasingly interconnected with the global economy across all markets. This has arisen from improvements in technology and reduced barriers to international trade, and the adoption of global value chain approaches to operations, particularly within multinational corporations.[27]

2.32 Tax treaties and other international tax agreements were intended to facilitate international investment and avoid double taxation. While they have been effective in achieving their intended purpose, they also provide organisations with mechanisms to exploit 'double non-taxation' opportunities.

Domestic treatment of foreign source income

2.33 As noted earlier, the tax treatment of foreign source income depends on the jurisdiction in which it is sourced and whether it is captured by Controlled Foreign Company (CFC) rules.

2.34 These arrangements are generally covered by treaties (bi- and multi- lateral) and avoid 'double taxation' of income in both jurisdictions. This is consistent with the notion of taxing income on a territorial basis. Such arrangements generally only apply to income that is 'actively' earned, not passive income (such as interest or rent).

2.35 Income from subsidiaries resident in jurisdictions that have similar tax systems to Australia, known as 'listed' jurisdictions, is generally exempt in corporate income tax considerations.

2.36 Income from subsidiaries resident in other jurisdictions, known as 'unlisted' jurisdictions, is generally liable for corporate income tax in Australia but may be given a tax credit for any tax already paid in a foreign jurisdiction.

2.37 Under Australia's Controlled Foreign Company (CFC) rules, domestic companies that have a controlling interest in a foreign company are liable to pay the Australian corporate tax rate on income from that company.

2.38 For example, even though BHP Billiton Marketing (Singapore Branch) pays almost no corporate tax in Singapore, its Australian parent company, BHP Billiton Australia, owns 58 per cent of the company and has been required to pay

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26 See, for example, the *Review of Australia's Future Tax System*, p. 155; and The Australia Institute, *Submission 62*, pp. 4–6.

27 *Submission 48*, p. 10.

A$945 million in 'top-up tax' to the ATO on the profits of BHP Billiton Marketing (Singapore Branch) for the period 2006 to 2014.[28]

Treatment of income sourced in Australia by foreign-based organisations

2.39 Where tax treaties exist between jurisdictions, companies can effectively choose the jurisdiction where they pay corporate income tax by creating permanent establishments in these jurisdictions. As Australia has a relatively high corporate income tax rate compared to other jurisdictions in the Asian region, it is not surprising that corporations will structure their operations so that they are based, and pay corporate tax, in jurisdictions where after tax profits are maximised.

2.40 Withholding tax is applied to unfranked dividends, interest payments and royalties for payments made to non-residents or foreign branches of Australian residents. The rate of withholding tax depends on the type of payment and the terms of any tax treaty that may be in place.[29]

2.41 In the context of the digital economy, tax integrity issues arise from the way in which income is recorded for corporate tax purposes where a foreign company provides 'digital services' (payment and provision) from a foreign jurisdiction. For example, the provision of advertising services over the internet where the service is purchased and consumed in Australia from a company based in a lower tax jurisdiction, such as Singapore, as in the case of Google and Microsoft. These structures often avoid permanent establishment status and enable multinational corporations to attribute revenue from Australian sources to foreign jurisdictions. As a result, this Australian sourced income may not currently be liable for Australian company income tax.

International related party dealings (IRPDs)

2.42 International related party dealings (IRPDs) represent the flow of cross border transactions between related entities (in the same corporate group).[30] They are a necessary and legitimate part of a multinational entity's global operations.[31]

2.43 IRPDs arise from the transfer of goods and services between jurisdictions, particularly where one jurisdiction serves as a regional base or is a centralised location for specific activities.

2.44 According to the ATO, the total value of IRPDs between Australia and all countries in 2012–13 was $326.7 billion (excluding derivatives, debt factoring and securitisation) which accounts for over half of the $599.6 billion in total trade.[32]

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28 BHP Billiton, *Answer to Question on Notice No. 14*, 24 April 2015, p. 1.

29 Australian Government, *Re:think—Tax Discussion Paper*, March 2015, p. 92.

30 ATO, *Submission 48*, p. 10.

31 ATO, *Answer to Question on Notice No. 7*, p. 3.

32 *Submission 48*, p. 10.

2.45 Singapore had by far the largest IRPD flows with over $100 billion exchanged in 2012–13, reflecting the importance of this jurisdiction as a hub for regional activities.[33]

2.46 While many foreign based multinational corporates, such as Google and Apple, have chosen to use Singapore as a regional base for operations in the Asia-Pacific, some large Australian mining multinationals, such as BHP Billiton and Rio Tinto, have strategically established operations in Singapore to act as a base for marketing their products.

2.47 Other Australian companies source their raw materials or final products from Singapore. For example, Australia imports the majority of its transport fuels from Singapore as it is the regional hub for the refining, trading and distribution of these products.

2.48 The value of IRPDs is highly concentrated within the largest 30 corporate entities which account for approximately 50 per cent of total IRPDs.[34]

2.49 Related party flows broadly reflect actual trade flows but there are some differences. In 2012–13, Australia's top five trading partners were China, Japan, the United States, Republic of Korea and Singapore, while the top five related party flows by country were Singapore, United States, Japan, Great Britain and Switzerland. The ATO considers the differences are due to the way in which trade flows are captured and may reflect the use of offshore hubs by multinational enterprises. For example, Singapore and Switzerland are commonly used as financing hubs for Asia and Europe respectively.[35]

2.50 Information about trade flows and IRPDs is useful to understand the operations of multinational corporations and to identify aggressive tax planning activities. However, as IRPDs are generally subject to internationally agreed 'arm's length' transfer pricing rules, the dollar value of related party transactions does not represent the amount of profits that are being artificially shifted from one jurisdiction to another.[36]

Tax avoidance and aggressive minimisation have broad impacts

2.51 Aggressive tax minimisation and avoidance can have a number of direct and indirect consequences for the broader economy and social fabric. Some submissions reflected growing concerns that tax avoidance causes serious harm, often to the most vulnerable groups in society, as unrealised corporate tax revenue denies governments revenue for essential public services, such as healthcare, education, effective law enforcement, aged care and roads.[37] In essence, failure to address base erosion and tax

33 ATO, *Answer to Question on Notice No. 7*, p. 11.

34 ATO, *Submission 48*, p. 10.

35 *Submission 48*, p. 11.

36 ATO, *Answer to Question on Notice No. 7*, p. 3.

37 Uniting Church of Australia, Synod of Victoria and Tasmania, *Submission 74*, p. 3 and Action Aid Australia, *Submission 67*, p. [2].

leakage means that the tax burden eventually falls more heavily on other taxpayers and/or government does not provide the same level of services it would otherwise be able to provide.

2.52 Also, if left unaddressed, tax avoidance reduces the efficiency, fairness and sustainability of the tax system. This leads to unfair competitive disadvantages for businesses that do the right thing and, ultimately, distorts investment decisions.[38]

2.53 Further, tax avoidance can undermine the integrity of the tax system and skew social and economic interactions by favouring those who can best afford to develop and implement the most effective tax strategy, usually large corporations and wealthy individuals. This has the potential to create widespread distrust and a reluctance to comply when others are not.[39] The Uniting Church of Australia, Synod of Victoria and Tasmania, noted the importance of trust and legitimacy in supporting the tax system:

> …it needs to be acknowledged that where a corporation is able to engage in tax avoidance without any counter-action being taken, it will encourage others to also engage in the same behaviour resulting in further loss of tax revenue.[40]

2.54 Maintaining public confidence in Australia's tax system is vital to ensure voluntary compliance and this confidence can best be fostered by preserving the integrity of the system.[41]

But so do legitimate tax planning activities

2.55 As discussed in chapter 1, the distinction between tax minimisation and tax avoidance is usually subtle, technical and largely open to opinion. Disputes between companies and the tax officials may arise when certain tax planning arrangements are considered to be 'aggressive' or not in the 'spirit of the law'. Tax minimisation only becomes avoidance when it is done for the sole or dominant purpose—not just an incidental purpose—of paying less tax.[42]

2.56 Indeed, the Australian tax system actively encourages minimisation by providing for deductions across a range of activities, and for various social and economic goals. For example, research and development tax concessions are intended to boost competitiveness and improve productivity across the Australian economy. This sentiment was conveyed by the Institute of Public Affairs:

> There is nothing wrong with an individual or company, structuring their affairs to pay the minimum legal amount of tax. In many cases the system

38 Treasury, *Addressing profit shifting through the artificial loading of debt in Australia*, Proposals Paper, 14 May 2013, p. 1.

39 Treasury, *Addressing profit shifting through the artificial loading of debt in Australia*, Proposals Paper, 14 May 2013, p. 1.

40 *Submission 74*, p. 3.

41 Minerals Council of Australia, *Submission 54*, p. 2.

42 The committee notes that this definition may change as a result of the proposed introduction of the Multinational Anti-Avoidance Law.

> has been deliberately designed to encourage that, for various social and economic goals. The complexity of the existing tax system reflects policy decisions. It is not accidental.[43]

2.57 Further, company executives and board members have a duty under corporations law to act in the best interests of a company's owners and maximise returns. As such, the concern over corporate and multinational tax avoidance, base erosion and profit shifting should perhaps better be viewed in light of the continuing exploitation of tax-effective minimisation opportunities that the law allows.

2.58 The important question for parliament and the broader community which they represent is not which instances of tax minimisation are unlawful but rather which ones are unacceptable. Unacceptable tax minimisation opportunities will require legislative amendment to remove their attraction as appeals to a collective corporate conscience are unlikely to change behaviour when companies insist that what they are doing is legal and in the interests of their shareholders.

43 *Submission 42*, p. 4.

Chapter 3

Evidence of corporate tax avoidance and aggressive minimisation

3.1 This chapter explores the evidence provided to the committee in respect to the frequency and importance of corporate tax avoidance and aggressive minimisation. Specifically, the chapter considers:

- the robustness and responsiveness of Australia's corporate tax system;
- recurrent and emerging challenges;
- the usefulness of effective tax rates; and
- existing measures to address corporate tax avoidance.

The robustness and responsiveness of Australia's corporate tax system

3.2 In general, stakeholders broadly indicated that Australia's corporate tax laws are strong and, in many respects, world leading. When combined with an effective tax administrator, high voluntary compliance rates are observed.[1] That said, the committee notes that there are a minority of very high profile multinational companies that pay little, if any, corporate tax in Australia despite deriving significant revenue from activities in Australia.

3.3 As the primary agency responsible for revenue collection, the Australian Taxation Office (ATO) is best placed to comment on the adequacy of the corporate tax system. In its submission, the ATO stated that most corporate taxpayers generally comply with the law based on the work it undertakes in relation to data analysis, economic trends and compliance assurance. According to the ATO:

> A suite of indicators generally suggests that companies are paying the income tax required under Australia's tax laws. Tax risk appetite has declined over the past decade.
>
> Company income tax receipts continue to move in line with macro-economic indicators, reflecting broad compliance by corporates with their income tax obligations.[2]

3.4 Indeed, companies that responded to the committee's request for information indicated that they fully comply with their obligations under Australia's tax laws and pay the required level of tax as assessed by the ATO. For certain transactions, disputes may arise with the ATO where there is a difference of opinion in how tax rules are interpreted and the tax consequences of these different interpretations. As discussed in chapter 6, the ATO encourages corporations to engage early with the ATO to

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1 See, for example, Ms Michelle De Niese, Corporate Tax Association, *Committee Hansard*, 10 April 2015, p. 56.

2 *Submission 48*, p. 34.

minimise the risks of a tax dispute emerging. The Tax Institute succinctly reflected the views of many participants:

> Australia is renowned for having one of the most complex and robust tax systems in the world. This complexity creates great difficulty for a taxpayer to navigate their way through the system to determine what their obligations may be under the Australian tax law. However, the robustness serves to markedly reduce the opportunity for a taxpayer to not comply with their obligations.[3]

3.5 The four big 'professional services' firms—Deloitte, EY, PricewaterhouseCoopers and KPMG—which provide tax advice and audit services to most large domestic and multinational corporations indicated that they hold Australia's tax system in high regard. For example, Deloitte considered that:

> …the Australian corporate tax system in its current form is extremely comprehensive and robust, is administered by a respected tax authority and generates a high degree of voluntary compliance. In seeking to reform and improve the Australian tax system, it is important to appreciate and build on the strengths of the current corporate tax system.[4]

3.6 And EY contented that:

> Australia's existing tax system is already considered to be robust internationally in preventing tax avoidance. Risks to revenue are consistently being identified by respective governments and dealt with as part of an ongoing law reform agenda.[5]

3.7 In addition to highlighting their concerns about the activities of some multinational corporations, the Uniting Church of Australia, Synod of Victoria and Tasmania, also indicated that many others pay the taxes they should in Australia.[6]

3.8 While Australia's tax system is generally held in high regard, concerns were raised that some specific aspects of the corporate tax system, including the complexity of the system, are enabling companies to reduce their tax obligations.

3.9 Reflecting the views of a number of participants, Mr Julian Clarke, CEO of News Corp Australia, was adamant that the current tax system was too complex:

> We find that the Australian tax system is incredibly complex, and you have to ask why. I am a very average sort of person. It is beyond my comprehension, the amount of detail that a company like ours has to deal with. I am not suggesting that it is not all important—it is—but surely there is a way of simplifying it.[7]

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3 *Submission 33*, p. 2.

4 *Submission 15*, p. 9.

5 *Submission 53*, p. ii.

6 *Submission 74*, p. 3.

7 *Committee Hansard*, 8 April 2015, p. 62.

3.10 And the costs of compliance are relatively high in the system because satisfying tax rules is generally complex, subjective and time consuming. PricewaterhouseCoopers indicated that qualified professionals were often required to assist corporations understand tax rules:

> Australia's tax laws are highly complex and are at times open to interpretation. Because of this, intermediaries, such as PwC Australia, play a vital role in enabling participation in Australia's tax system and contributing to its operation. Just as the tax laws are set by Australia's elected Parliament, and the tax system is administered by the ATO, qualified tax advisers provide a vital service by helping people understand the complexity and structure of tax rules.[8]

3.11 Further, the interaction of tax systems across jurisdictions adds to the complexity and acts to further facilitate corporate tax avoidance. According to Action Aid Australia:

> The varying rules and regulations between the residence country and source country, as well as companies having the ability to declare their actual residence in a completely different country that serves as a tax haven, result in an exceptionally convoluted system that facilitates corporate tax avoidance.[9]

3.12 Tax treaties also play a role in facilitating tax avoidance as described by Mr Martin Lock:

> Corporate tax planning thrives on complex, uncertain and inequitable laws. Inequity arises when two or more laws produce substantially different tax outcomes for substantially the same transaction depending on which of those laws are triggered.
>
> Inequity commonly arises from differences in tax rules and in tax rates across different double tax agreements, or 'tax treaties'. A tax treaty grants rights to Australia to tax residents (which can include companies) of the other treaty country but it also limits those rights, sometimes quite significantly. Resident and foreign resident companies in Australia often can easily establish a subsidiary in a tax treaty country that best suits the group's tax plan and can then transfer assets, or channel Australian sourced income, to it. Different assets and different kinds of income can be transferred or channelled to whichever subsidiary or branch in whichever treaty or non-treaty country best suits the plan. A variety of beneficial tax provisions in treaties offers choice.[10]

Recurrent and emerging challenges

3.13 As the primary tax authority, the ATO provided the following assessment of what it considers to be the main risks to the corporate revenue base:

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8 *Submission 39*, p. 3.

9 *Submission 67*, p. 2.

10 *Submission 56*, pp. 9–10.

> …over the past four years the nature and risks in the corporate marketplace has remained relatively unchanged, with one exception—the growing base erosion and profit shifting risk.[11]

3.14 Base erosion and profit shifting (BEPS) refers to tax planning arrangements that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax jurisdictions where there is little or no real activity.[12]

3.15 It is how multinational activities are structured and accounted for that poses the greatest base erosion risk:

> Increasing globalisation, the continuing growth of e-commerce and the enhanced capabilities of large multinational corporations to engage in financial engineering has seen the use of tax planning or structuring to avoid tax. These arrangements are complex, deal with significant amounts and involve a range of interactions with the tax system, giving rise to both income tax and indirect tax liabilities and entitlements, at both the corporate and shareholder level.[13]

3.16 The base erosion and profit shifting risks identified by the ATO that relate to profit shifting activities of multinational corporations are well known. The practices that present these risks to the integrity of the tax system are:

- transfer pricing (for example, non-arm's length pricing of related party dealings—often there are different views, particularly about valuations and comparable benchmarking);
- thin capitalisation (funding Australian operations using excessive debt);
- international restructures and adopting global supply chains, with profit shifting consequences;
- complex financing arrangements that result in 'stateless' or untaxed income; and
- digital business platforms that have large economic presence in a jurisdiction relative to the tax contribution.[14]

3.17 The ATO considers that the main risks to the corporate tax system posed by multinationals are increased debt deductions, an absence of permanent establishment in Australia and aggressive transfer pricing.[15]

3.18 The Uniting Church of Australia, Synod of Victoria and Tasmania, made a similar assessment:

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11 *Submission 48*, p. 22.

12 OECD, *BEPS – Frequently Asked Questions*, http://www.oecd.org/ctp/beps-frequentlyaskedquestions.htm#background (accessed 30 July 2015).

13 ATO, *Submission 48*, p. 25.

14 *Submission 48*, pp. 23–24.

15 Economics Legislation Committee, *Estimates Hansard*, 2 June 2015, p. 15.

> The indicators of increased risk of MNE [multinational enterprise] tax avoidance include increased use of subsidiaries in secrecy jurisdictions, business restructures like digital duplication of domestic businesses to shift profits to a low tax jurisdiction, pricing mismatches with large mark-ups ending up in an offshore service hub, creation of stateless income, tax arbitrage via hybrid entities/instruments, treaty abuse, the alienation of intangibles at 'non arms-length' prices, debt dumping into Australia and 'innovative' financing arrangements.[16]

3.19 Stakeholders generally agreed that the biggest risk to corporate tax revenue was base erosion and profit shifting by foreign based multinationals. Professor Kerrie Sadiq, from the Queensland University of Technology, contended that:

> …appropriate taxes are not being paid in the location of economic activity. Tax rules need to focus on the underlying economic substance of transactions. To this end, the current laws are inadequate and out of date.[17]

3.20 Professor Richard Vann, Challis Professor of Law from the University of Sydney, considered that the major tax risk for Australia is likely to be foreign corporates with local sales. He explained that, because dividend imputation is largely irrelevant to foreign multinationals and their shareholders, it was a key reason they posed the greatest risk to the corporate tax revenue base:

> …the real risks for Australia are mainly the foreign corporates. Imputation does not impact them. The shareholders of those companies get no benefit out of imputation. So there is no natural floor on the tax planning in which they can engage.[18]

3.21 This view was supported by the Uniting Church of Australia, Synod of Victoria and Tasmania:

> Multinational companies that gain the greatest benefit from tax dodging in Australia will be foreign based multinationals operating in Australia, as any tax dodging is likely to be of direct benefit to the shareholders or owners of the company. It is then likely that privately owned Australian based multinational corporations have the next highest incentive to dodge paying tax in Australia, as again any tax dodging on corporate income tax is likely to be of benefit to the owners.[19]

3.22 Profit shifting risks by large and medium sized multinationals and private groups can present complex challenges for the ATO which may lead to costly and drawn out disputes. The operational approach taken by the ATO to identify and address these issues is discussed in chapter 6.

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16 *Submission 74*, p. 5.

17 *Submission 93*, p. 1.

18 *Committee Hansard*, 8 April 2015, p. 11.

19 *Submission 74*, pp. 3–4.

3.23 While there are concerns about the tax practices of many private companies, particularly those controlled by wealthy individuals, the ATO appears to have processes in place to actively monitor and address these risks.[20]

3.24 The base erosion and profit shifting issues that Australia faces are no different from other jurisdictions. According to the OECD:

> The debate over BEPS has also reached the political level and has become an issue on the agenda of several OECD and non-OECD countries.[21]

3.25 In response to these long standing concerns, the OECD embarked on an ambitious multilateral reform project in 2013 to develop a coordinated response to address base erosion and profit shifting. This initiative is explored in detail in chapter 4.

Transfer pricing

3.26 Transfer pricing is the setting of the price of goods and services sold between controlled (or related) entities within an enterprise. Transfer prices are important as they are a significant contributor to income and expenses, and therefore taxable profits, of associated entities in different tax jurisdictions.[22]

3.27 Transfer pricing is one of the main ways to undertake tax arbitrage by shifting profits from high to low tax jurisdictions. The OECD considers the establishment of transfer prices for tax purposes to be one of the most difficult issues associated with the taxation of multinational enterprises.[23]

3.28 The Business Council of Australia succinctly outlined the issues associated with transfer pricing:

> Long-standing rules require transactions between related businesses to be priced comparably with those between independent parties, the so-called arm's length principle. However, in practice, the transfer price can be difficult to determine if there is no comparison price, or with unique transactions or assets, such as intellectual property rights. This gives rise to ambiguity of interpretation and complexity of outcomes and decisions.[24]

3.29 Indeed, Professor Vann indicated that intellectual property was an important factor in facilitating profit shifting:

> Companies with a lot of intellectual property are the ones who have the biggest opportunity to shift profits. This is not just the big tech companies,

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20 *Submission 48*, p. 19.

21 OECD, *BEPS—Frequently Asked Questions*, http://www.oecd.org/ctp/beps-frequentlyaskedquestions.htm#background (accessed 30 July 2015).

22 OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrators*, July 2010, p. 19.

23 OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrators*, July 2010, p. 19.

24 *Submission 87*, Attachment 3, p. 1.

> but most of our companies. BHP has intellectual property in the form of the way it mines and the technology it uses. But, compared to its value, that is a relatively small part of its value. For Google, Apple et cetera, their intellectual property is a much larger part of their value. They are the companies where the profit shifting is the greatest.[25]

3.30 The OECD transfer pricing guidelines provide a variety of methods for calculating appropriate transfer prices consistent with the arm's length principle. The two main categories are:

- Traditional transaction methods—the comparable uncontrolled price (CUP) method, the resale price method and the cost plus method—are regarded as the most direct means of establishing whether commercial and financial relations between associated entities are arm's length.[26]
- Transactional profit methods—the transactional net margin method and the transactional profit split method—may be the most appropriate method in certain circumstances. Such circumstances include where entities have highly integrated activities, where there is no or limited publicly available gross margin information on third parties, or where each of the parties makes valuable and unique contributions in relation to a controlled transaction.[27]

3.31 Throughout the inquiry, the committee was provided with numerous examples from a variety of industries where multinationals were potentially using transfer pricing to minimise their Australian tax obligations. The investigation by the committee centred on whether the transfer prices charged to Australian subsidiaries actually reflected an appropriate revenue split.

Foreign supply of goods and services that embody significant amounts of intellectual property

3.32 The setting of transfer prices and how these prices affect profits, and ultimately tax liabilities, is important for companies providing products and services that embody considerable amounts of intellectual property and intangible goodwill, particularly in the pharmaceutical industry and the digital economy. As many products are developed for the global market, transfer pricing issues can arise in countries where final products are sold but not developed.

3.33 In Australia, transactional profit methods appear to be favoured by the majority of these multinationals and many companies seek Advanced Pricing Arrangements (APAs) from the ATO to guide the determination of transfer prices over a fixed period of time. The use of transactional profit methods and APAs has raised concerns within the committee about the relatively low profitability level of, and associated tax paid by, Australian subsidiaries.

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25 *Committee Hansard*, 8 April 2015, p. 15.

26 OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrators*, July 2010, pp. 59–60.

27 OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrators*, July 2010, pp. 59–60.

3.34 Many products and services in the digital economy contain and/or use technologies that have required substantial research and development costs for innovations that may or may not have been commercialised.

3.35 In the case of Apple, the committee questioned whether it was plausible that the Australian subsidiary could have a taxable income of only $247 million from revenue of $6,073 million in 2013–14, effectively representing an operating margin before tax of just over 4 per cent.[28] As a result, Apple paid only $80 million in tax for this period which appears to the committee to be low given the company is very profitable globally.

3.36 Apple responded that it had participated in the ATO's advanced pricing agreement (APA) program since 1991 in order to apply an agreed arm's length principle to these international related party transactions.[29] A profit-based method was deemed to be the most appropriate method to apply the arm's length principle, specifically a Transaction Net Margin Method. As such, Apple Australia's cost of purchasing products from affiliates is not calculated on a product by product basis.[30]

3.37 This profit-based approach to determining arm's length transfer prices is applied consistently in other countries across Europe and the Asia Pacific region where there are Apple subsidiaries with a similar distribution business model to Apple Australia.[31] However, this does not mean that Australian consumers pay comparable retail prices for Apple goods and services than other jurisdictions.

3.38 Apple acknowledged that its APA was not rolled over when it came up for renewal and that the ATO is 'contesting whether these affiliate sales have been struck at a fair price'.[32]

3.39 Apple is part of a group of 12 companies in the 'e-commerce IT area' that the ATO has 'under review either for using structures that do not declare sales or for using aggressive pricing to shift profits out of Australia'.[33]

3.40 Multinational pharmaceutical corporations generally have large research and development costs associated with identifying and bringing novel pharmaceuticals to market. This process generally involves substantial and uncertain investment in underlying research, clinical trials and commercialisation of products. According to Medicines Australia, whose members comprise the majority of the Australian pharmaceutical industry:

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28 Apple Australia, *Submission 66*, p. [2]; *Answer to Question on Notice No. 17*, 28 April 2015, p. 3.

29 *Committee Hansard*, 8 April 2015, p. 46.

30 Apple Australia, *Answer to Question on Notice No. 17*, 28 April 2015, p. 1.

31 Apple Australia, *Answer to Question on Notice No. 17*, 28 April 2015, p. 2.

32 Mr Chris Jordan, *Committee Hansard*, 22 April 2015, p. 2.

33 Mr Tony King, *Committee Hansard*, 8 April 2015, p. 49; Mr Mark Konza, *Committee Hansard*, 22 April 2015, p. 9.

> …pharmaceutical companies that distribute in Australia purchase products from their parent companies or manufacturing subsidiaries, with a fixed range of profit rate that is often agreed with the ATO. This profit rate range is based on an independent, arm's length comparator entity, which reflects on the risks, assets and functions in Australia.[34]

Marketing hubs for multinational mining companies

3.41 The marketing arrangements of mineral exports were raised as another area where multinational resource companies may be taking advantage of transfer pricing to reduce their corporate tax obligations in Australia. In particular, the use of marketing hubs based in Singapore to add value to the export of iron ore and other commodities was explored as part of the committee's deliberations.

3.42 In the context of this inquiry, marketing hubs (also known as commercial centres) are intergroup structures that purchase commodities from Australian resource extractors and facilitate the sale and delivery of these resources to final customers. The two largest Australian resource companies, BHP Billiton and Rio Tinto, both have marketing hubs in Singapore.

3.43 BHP Billiton's centralised marketing organisation is headquartered in Singapore and employs approximately 400 people. It is responsible for:

- providing a well-informed, analytically rigorous and insightful view of long run supply, demand and pricing of commodities;
- presenting one face to markets and customers across multiple commodities;
- managing the supply chain from assets to markets;
- understanding how products are used by customers and how their particular needs are evolving; and
- maximising sales prices.[35]

3.44 BHP Billiton indicated that, while transactions between its Australian and Singapore operations are conducted on an arm's length basis, it still earnt profits from its Singapore marketing operations of US$5.7 billion between 2006 and 2014 on which the tax paid in Singapore was US$121,000.[36] However, BHP Billiton submitted that:

> All of the value of production of our commodities here in Australia is subject to Australian tax…This means that when we sell Australian commodities to a customer, nearly 100 per cent of those sale proceeds are captured within the Australian tax net.[37]

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34 *Supplementary Submission 103.1*, p. 2.

35 *Answer to Question on Notice No. 14*, p. [i].

36 *Answer to Question on Notice No. 14*, p. 1.

37 *Committee Hansard*, 10 April 2015, p. 62.

3.45 Consistent with the dual structure created as part of the merger between BHP Limited and Billiton Plc, the Singapore marketing entity is 58 per cent owned by BHP Billiton Limited in Australia. As a result, 58 per cent of the profits are liable for Australian company income tax under the Controlled Foreign Company (CFC) rules. This meant that BHP Billiton has paid 'top-up' tax of A$945 million on the profits from the Singapore marketing operation.[38]

3.46 BHP Billiton also indicated to the committee that it had a number of open ATO actions for commodity transfer prices and CFC rules as they related to the Singapore marketing operations. The total value in dispute was A$522 million (including interest and penalties). The company has put aside US$339 million in contingent liabilities for these matters.[39]

3.47 Rio Tinto also has a commercial centre in Singapore that undertakes marketing activities, shipping, procurement and other services. This commercial centre employs around 330 people and undertakes activities that, according to Rio Tinto, could not be sensibly undertaken elsewhere.[40]

3.48 As a result of the value adding activities undertaken by its commercial centre in Singapore on operations globally (not just commodities sourced from Australia), Rio Tinto made a profit from these activities of $719 million in 2014.[41]

3.49 In relation to the tax implications of the activities of its commercial centre, Rio Tinto explained that:

> Before we undertook any activities in Singapore, we went to the tax office and talked to them about the price that they would charge for those activities on the basis of seeking to agree and that was an appropriate arm's-length price…
>
> We have various transfer pricing matters that we have ongoing discussion with the tax office in relation to.[42]

3.50 In response, the ATO indicated that transfer pricing for commodity sales to marketing hubs was an ongoing issue of concern:

> We are in the stage of an open audit, we are disputing their [Rio Tinto and BHP Billiton's] hub activities. Rio [Tinto] were quite transparent with you and disclosed that their Singapore hub made a profit of $719 million in one year. That is precisely the issue that we are disputing. Is it reasonable to say the activities that were carried on by that Singapore hub should generate three-quarters of a billion dollars profit, largely not subject to tax in

38 *Answer to Question on Notice No. 14*, p. 1.

39 *Answer to Question on Notice No. 14*, pp. 2–3.

40 *Committee Hansard*, 10 April 2015, p. 65.

41 *Committee Hansard*, 10 April 2015, p. 65.

42 Mr Phil Edmands, *Committee Hansard*, 10 April 2015, p. 68.

> Singapore, or whether a substantial part of that should be attributed back to the operations here in Australia?[43]

Committee view

3.51 While the committee accepts that there are significant costs associated with the development of intellectual property, it is not convinced that the current arrangements of some multinational corporations providing goods and services using this intellectual property are appropriately allocating revenue consistent with the value added in the provision of these goods and services to Australian consumers.

3.52 The committee is continuing to explore transfer pricing issues, particularly in relation to the pharmaceutical industry and other industries that use transactional profit methods to determine transfer prices, and intends to cover these issues in more detail in the final report.

Avoiding permanent establishment by providing goods and services from another jurisdiction

3.53 One of the challenges for international tax policy, particularly with the emergence of digital technology, is how to allocate income appropriately and fairly between jurisdictions where products and services are purchased in one country but ostensibly supplied in another country. The main examples examined by the committee during the inquiry were structures used by Google and Microsoft to effectively supply the Australian market from Singapore.

3.54 In the case of Microsoft, the committee was interested to learn that revenue from Australia is predominantly booked for accounting purposes in Singapore in the Asia Pacific regional operating centre [ROC]. Mr Bill Sample, Corporate Vice-President, Worldwide Tax, outlined Microsoft's organisational structure and where Australia fits in:

> Regional production, marketing and G&A [general and administration] functions are performed by the Singapore ROC…Microsoft local subsidiaries, such as Microsoft Australia, receive an arm's length compensation paid by the ROC which takes into consideration the functions performed, assets owned and the risks assumed by each entity.[44]

3.55 The majority (85 per cent) of Microsoft's research and development is undertaken in the United States and its Australian operations are marketing, service and support subsidiaries. As such, non-consulting services and software product revenue is billed and accounted for on the Singapore group books.[45]

3.56 Mr Chris Jordan, Commissioner of Taxation, reflected on the evidence provided by Microsoft:

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43 Mr Chris Jordan, *Committee Hansard*, 22 April 2015, p. 4.

44 *Committee Hansard*, 8 April 2015, p. 44.

45 *Committee Hansard*, 8 April 2015, p. 51.

> Microsoft stated that the profits from its Australian business are earned primarily in Singapore—approximately $2 billion with $100 million remaining in Australia. The ATO audit of Microsoft is trying to determine if this is the appropriate split of revenue.[46]

3.57 The committee acknowledges that Microsoft provides some legitimate services from the Singapore ROC, such as software updates from resident servers. By using this business structure, however, Microsoft does not appear to pay corporate tax in Australia on the majority of revenue it sources from Australians.

3.58 Similarly, Google has a regional head office in Singapore and an Australian subsidiary. The Australian subsidiary is responsible for providing sales and marketing support services to Australian businesses and users, and provides research and development services to Google globally.[47]

3.59 Revenue from Australian activity is billed and taxed through Google's regional head office in Singapore and Google Australia receives payments from other Google entities (Google APAC and Google Inc) for the provision of local services.[48]

3.60 Google Australia reported a profit of just over $46 million on revenues of $358 million in 2012–13. It paid only $7.1 million in corporate tax, however, as it was able to claim a research and development tax credit to the value of $4.5 million.[49]

3.61 In response to her own question about why Google Australia does not pay more corporate tax in Australia, Ms Maile Carnegie, Managing Director of Google Australia, said:

> …like many other multinational corporations, whether they are digital or otherwise, we pay the lion's share of our taxes to the country where our headquarters is based…So at Google, our success and our profits stem from our intellectual capital, and that is the technology that helps to drive things like the algorithm which provides what we think is the most relevant answer to whatever search you put into Google Search…This intellectual capital was developed outside of Australia, and this intellectual capital is owned outside of Australia.[50]

3.62 In response to questions on notice, Google indicated that it paid US$3.3 billion in tax worldwide in 2014 on revenues of US$66 billion.[51] Its overall effective tax rate was 19 per cent, compared to the statutory federal rate of 35 per cent in the US, where Google is headquartered. If Google is paying the 'lion's share' of its taxes in the US, then it would follow that it is not paying very much tax at all on the profit it derives from all the other foreign jurisdictions where it operates.

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46 *Committee Hansard*, 22 April 2015, p. 2.

47 *Committee Hansard*, 8 April 2015, pp. 42–43.

48 *Answer to Question on Notice No. 11*, p. 1.

49 *Committee Hansard*, 8 April 2015, pp. 43, 50.

50 *Committee Hansard*, 8 April 2015, p. 43.

51 *Answer to Question on Notice No. 33*, p. 2.

3.63 In Singapore, for example, Google paid only US$4 million in company tax in 2013 on undisclosed revenues not just from Australia but other countries in Asia-Pacific.[52] By contrast, Google Australia paid A$7.1 million in company tax during the same period without accounting for the majority of that revenue being booked in Singapore.[53]

3.64 Google did not provide details of the revenue it sources from Australia. Google's response indicated that:

> Google Inc does not break out revenue by country source, unless revenue from that country exceeds 10% of total revenue….Our current reports don't break Australia's number out separately.[54]

3.65 As such, the committee has not been able to verify media reports that indicated that Google's revenue from Australia for advertisements was around $2 billion.[55] However, if these media reports are correct, Google Australia's operating margin on revenue sourced from Australia would represent 2.3 per cent, almost a tenth of the worldwide operating margin of 23 per cent in 2013.

3.66 Google and Microsoft, together with Apple, are part of a group of 12 companies in the 'e-commerce IT area' that the ATO has 'under review either for using structures that do not declare sales or for using aggressive pricing to shift profits out of Australia'.[56]

Committee view

3.67 The committee is concerned that the tax incentives afforded by overseas jurisdictions to some multinational companies are facilitating aggressive tax minimisation and the erosion of Australia's tax base.

Recommendation 1

3.68 The committee recommends that the Australian Government work with governments of countries with significant marketing hub activity to improve the transparency of information regarding taxation, monetary flows and inter-related party dealings.

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52 *Answer to Question on Notice No. 33*, p. 2.

53 *Answer to Question on Notice No. 22*, p. [1].

54 *Answer to Question on Notice No. 11*, p. 1.

55 N. Chenoweth, 'Yes, Google does pay tax on $2 billion in revenue: $5 million in Singapore', *Australian Financial Review*, 13 April 2015, http://www.afr.com/technology/technology-companies/google/yes-google-does-pay-tax-on-2-billion-ad-revenue-5-million-in-singapore-20150414-1mjymy (accessed 2 June 2015).

56 Mr Bill Sample and Ms Maile Carnegie, *Committee Hansard*, 8 April 2015, p. 49; Mr Mark Konza, *Committee Hansard*, 22 April 2015, p. 9.

Debt loading, complex financing arrangements and international restructures

3.69 There are a number of other mechanisms by which multinationals can aggressively minimise their tax obligations in one jurisdiction by shifting profits and/or taxing rights to another jurisdiction.

Debt loading and complex financing arrangements

3.70 High levels of debt can be an important contributor to providing funding for capital intensive projects, such as for financing infrastructure assets and facilitating resource extraction. High debt levels alone are not an indicator of aggressive minimisation but when combined with relatively high interest rates to related subsidiaries questions may be asked as to whether these arrangements are intended to shift profits.

3.71 Debt loading enables companies to claim excessive interest deductions on earnings, which can then reduce assessable income, through artificially increasing the amount of debt carried by an associated Australian entity.

3.72 A subsidiary of a multinational company in a low tax jurisdiction can provide a loan to a subsidiary in high tax jurisdiction, thereby facilitating profit shifting as the interest payments are deductible in the high tax jurisdiction and the income received is taxed at a lower rate in the low tax jurisdiction. Currently under the thin capitalisation rules in Australia, companies can claim deductions for interest on debt up to a 60 per cent debt-equity ratio for their operations.

3.73 Complex financing structures are often used by multinational corporations to transfer financial resources between subsidiaries in different jurisdictions. Hybrid mismatch arrangements can arise when equivalent entities, instruments or transfers are treated differently for tax purposes in different jurisdictions. These arrangements can have beneficial tax implications and lead to double non-taxation (or 'stateless' income) or a particular loss or deduction being able to be claimed in both jurisdictions.

3.74 The committee is concerned that selective debt loading practices are enabling some multinational organisations to continue to shift profits from Australian operations to lower tax jurisdictions. Rather than continue with the current thin capitalisation rules, a fairer way to determine an appropriate debt deduction is to base the tax deduction on a company's entire global operations.

3.75 The committee does not consider it appropriate that corporations can exploit hybrid mismatches to avoid corporate tax. As such, it considers that Australia's rules on hybrid entities and instruments be better aligned with tax laws in other countries and be consistent with OECD guidelines.

International restructures

3.76 There can be tax benefits from undertaking operational restructuring which shifts activities and assets between high and low tax jurisdictions. Restructuring is undertaken by some corporations, either independently or as a result of takeovers, and

the ATO sees risks here too in areas such as consolidation, taxation of financial arrangements, capital gains tax, and infrastructure investment.[57]

3.77 Although no specific claims were made in the course of the inquiry about aggressive minimisation in relation to corporate restructuring, there have been examples of tax disputes arising from these activities. The most high profile case in recent years has been TPG Capital's privatisation and subsequent public float of Myer where the ATO made an initial income tax claim of $678 million.[58] Ultimately, the ATO was not successful in its claim but this example illustrates that there are opportunities for aggressive minimisation through corporate restructuring which contribute to base erosion.

3.78 At the 2015–16 Budget Estimates hearing, Mr Rob Heferen, Treasury Deputy Secretary, indicated that:

> …if an issue comes up about taxpayer affairs, that is taken into account [by the Foreign Investment Review Board]…There may be instances where the issue about how much tax a firm paid and how much they might pay may be relevant to the determination of the national interest.[59]

3.79 According to *Australia's Foreign Investment Policy*, the Australian Government 'considers the impact of a foreign investment proposal on Australian tax revenues' as part of national interest considerations.[60]

Comparing effective tax rates has limitations

3.80 Effective tax rates are a measure of tax paid compared to the underlying profit before tax. According to the Business Council of Australia:

> Accounting standards define the effective tax rate by reference to current and deferred tax expense, divided by the accounting profit.[61]

3.81 However, the methods for determining effective tax rates are widely debated in academic literature.[62] For example, there are a number of different methods available that reflect different views on using an economic, compared to an accounting, perspective. Indeed, the Business Council of Australia noted that:

> There is no single measure of effective tax rates. It is important to consider the precise nature of the measure to ensure meaningful information can be drawn from it.[63]

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57 *Submission 48*, p. 26.

58 Economics Legislation Committee, *Estimates Hansard*, 16 February 2012, p. 128.

59 Economics Legislation Committee, *Estimates Hansard*, 2 June 2015, p. 22.

60 Treasurer, *Australia's Foreign Investment Policy*, June 2015, p. 7.

61 *Submission 87*, p. 8.

62 Dr Roman Lanis and Mr Ross McClure, *Submission 75*, pp. 58–70.

63 *Submission 87*, p. 9.

3.82 In order to stimulate discussion about corporate tax in Australia, the Tax Justice Network undertook a detailed examination of the effective tax rates of Australia's top 200 publicly listed companies (ASX 200) and other data relating to all taxpayers. The research undertaken by the Tax Justice Network Australia indicated that Australian companies of all sizes were not paying the statutory tax rate of 30 per cent and, based on this assumption, the potential tax foregone was $9.3 billion. The majority of this loss comes from companies earning an income over $10 million.[64]

3.83 While acknowledging the limitations of its analysis, the Tax Justice Network Australia considered that this research was important to:

> …open up opportunities for deeper analysis and enable stakeholders to meaningfully engage with companies about responsible tax practices. Australians need to hold corporations and governments to account by addressing corporate tax avoidance and its consequences.[65]

3.84 The committee asked ASX 200 companies to clarify their effective tax rates and to respond to the claims made by the Tax Justice Network Australia. The companies that responded highlighted the limitations of that analysis and sought to correct the record. In the main, they highlighted that effective tax rates should be calculated on taxable income, not accounting profits.

3.85 Other companies, peak bodies and government agencies also contested the analysis presented by the Tax Justice Network Australia and criticised the methodology used for not incorporating the subtle complexities of the tax system. Consistent with ASX 200 companies, these stakeholders brought to the committee's attention the distinction between assessable (or taxable) income and other commonly used measures, such as accounting profits and earnings before allowable deductions. For example, the Business Council of Australia explained that:

> The calculation of taxable income and accounting profits differ due to permanent and timing differences. The tax system deliberately departs in many areas from the use of accounting principles in determining taxable income. Some of these key differences…include the treatment of carry forward losses, depreciation, foreign income, dividend imputation, research and development, and property trusts.[66]

3.86 This sentiment was echoed by Mr Heferen:

> A fundamental feature of our tax system is that we do not tax companies on their accounting profit. Companies are taxed on their taxable income. [That] This differs from accounting profit in many ways reflects the clear policy choices of governments over time. Losses, foreign income, capital gains, accelerated depreciation, and research and development are all areas where,

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64 Tax Justice Network Australia, *Who Pays for Our Common Wealth? Tax Practices of the ASX 200*, October 2014, p. 13.

65 Tax Justice Network Australia, *Who Pays for Our Common Wealth? Tax Practices of the ASX 200*, October 2014, p. 7.

66 *Submission 87*, p. 14.

> for a range of legitimate reasons, governments have decided to tax companies on a different basis than their accounting treatment. So an observation that a company has an effective tax rate of less than 30 per cent is merely that—an observation of fact. It gives no insight as to whether the tax paid is appropriate or not.[67]

3.87 Further, Mr Heferen explained that the effective tax rate is generally not intended to be equal to the statutory rate:

> With accounting profit and taxable income for some businesses some of the time there could be a degree of similarity, and, in fact, a recent report said that if you used accounting profit a lot of firms are earning 26 per cent rather than 30. I must confess I was surprised it was so high. But when you get right down to it, there are intended significant differences. Research and development tax concessions are a classic. Accelerated depreciation is another standard. The carried forward loss is another one…The other one is interest cost.[68]

3.88 Income from foreign sources can also distort the calculation of effective tax rates, depending on its tax treatment both overseas and when it is repatriated.

3.89 In addition, corporate structures that are taxed on a flow-through basis, such as property trusts, do not pay corporate tax but transfer the tax obligations to their owners (which may be individuals or other corporations).

3.90 So while effective tax rates might superficially appear to be an indicator of tax avoidance or aggressive minimisation, there may be legitimate reasons why they differ from the statutory corporate tax rate.

3.91 While the committee accepts that the research presented by the Tax Justice Network Australia has limitations, it considers that this work has provided a valuable platform for opening up the discussion about the extent to which both public and private companies should provide information on their financial and taxation affairs to the community. As the Tax Justice Network Australia noted:

> Disclosure and transparency of corporate tax practices needs to be increased. Greater public awareness of aggressive tax planning will provide an incentive to Australian corporations to be less tax aggressive. Tax dodging practices, when exposed, will damage corporate reputations and may increase regulatory and financial risks. Responsible companies should not wait for inevitable changes to the rules before deciding to act.[69]

3.92 The committee also asked a number of foreign based multinationals—such as leading technology and pharmaceutical corporations—to provide details of their effective tax rates for their Australian operations. The responses received noted that

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67 *Committee Hansard*, 9 April 2015, p. 18.

68 Economics Legislation Committee, *Committee Hansard*, Supplementary Estimates 2014-15, 22 October 2014, p. 167.

69 Tax Justice Network Australia, *Who Pays for Our Common Wealth? Tax Practices of the ASX200*, October 2014, p. 9.

these companies generally paid relatively high effective tax rates on Australian profits, close to the statutory rate of 30 per cent.

3.93 But, as discussed earlier, the level of profit from Australian operations appeared to be low compared to the level of revenue and global profitability of these companies. This raises concerns about whether these companies are engaging in aggressive tax planning practices to shift profits outside Australia.

3.94 Where a standardised approach to calculating effective tax rates is employed, the results can be used to compare the relative tax paid by corporations and may be useful in identifying tax avoidance and aggressive minimisation, particularly in multinational corporations.

3.95 The committee notes that the ATO is developing an 'effective tax borne' formula which is intended to 'assess the global tax performance of multinationals in relation to Australian-linked business operations'.[70] It is aimed at encouraging a broader discussion about the need for, and appropriateness of, a standardised approach to calculating effective tax borne.

3.96 A detailed explanation of the effective tax borne formula and underlying methodology can be found in appendix 1. According to the ATO:

> This metric deliberately includes the profits of the economic group which may not be taxable in Australia under Australia's source, residency and anti-profit shifting rules or the OECD/Double Tax Agreement principles intended to avoid double taxation. The metric seeks to reflect all of the channel profit derived from business activities involving Australia and the Australian and global tax paid on that channel profit.
>
> …By including the entire economic group's profit from Australian linked activities, international relative party dealings are effectively ignored.[71]

3.97 The committee welcomes the efforts of the ATO to bring clarity and consistency to the debate on effective tax rates and fully supports the continued work of the ATO in this area.

Australia has measures to address multinational tax avoidance

3.98 Australian tax administrators and policy advisors are vigilant in identifying and proposing solutions to emerging problems. Recent attempts to strengthen the corporate tax system reflect the willingness of these agencies to confront problems directly. For example, the ATO has an important and influential role in assisting Treasury and the government to design and implement efficient and effective laws. According to the ATO:

> We monitor the system closely and work with Government and Treasury in relation to any changes required to ensure the health of the tax system and its administration. Reforms have been implemented to improve transfer pricing and thin capitalisation rules in Australia, as well as globally the

70 ATO, *Answer to Question on Notice No. 18*, 1 May 2015, p. [3].

71 ATO, *Answer to Question on Notice No. 18*, 1 May 2015, p. [4].

> ATO is supporting the G20/OECD to drive 15 action items to address base erosion and profit shifting.[72]

3.99 And Mr Heferen, reinforced this statement:

> The Treasury and the ATO are continually examining our tax system to identify areas where taxpayers are engaged in egregious tax avoidance, consider where new compliance initiatives might be best targeted and also advise government on how our laws could be improved to deal with these issues.[73]

3.100 Stakeholders shared the view that the corporate tax system and its administrators have the flexibility to respond appropriately to emerging issues in a timely manner to address emerging problems. Professor Kerrie Sadiq noted that:

> We currently have a robust and sophisticated international tax regime and we have been proactive in amending law where needed, for example updating the transfer pricing regime and thin capitalisation provisions.[74]

3.101 While KPMG stated that:

> …both the ATO and the government of the day respond quickly and effectively to risks to the revenue base.[75]

3.102 A number of stakeholders highlighted the specific initiatives undertaken by the Australian Government to enhance the corporate tax system and address specific base erosion issues. These initiatives and existing features of the corporate tax system have created one of the strongest systems globally to combat tax avoidance. These anti-avoidance features of the tax system were described succinctly by KPMG:

- Australia has what is widely considered one of the most robust general anti-avoidance provisions of any tax system in the world, in Part IVA of the 1936 [Income Tax Assessment] Act. Part IVA was further strengthened in 2013 in response to a number of court decisions viewed as contrary to the policy of the legislation.
- Australia's thin capitalisation rules, which limit the amount of debt on which interest can be deducted against Australian assessable income, were amended and tightened in 2014.
- Australia amended its transfer pricing rules in 2012 and 2013, which seek to ensure that an appropriate amount of taxation is attributed to Australian-based activities, giving the ATO the power to 'reconstruct' commercial transactions.
- The imputation and franking system encourages Australian registered companies to pay Australian tax in preference to foreign tax for the

72 *Submission 48*, p. 3.

73 *Committee Hansard*, 9 April 2015, p. 18.

74 *Submission 93*, p. 1.

75 *Submission 91*, p. 4.

benefit of Australian resident shareholders. This creates a systemic bias in favour of tax being paid in Australia.

- Australia has a comprehensive 'controlled foreign companies' (CFC) regime that seeks to tax certain types of income in jurisdictions designated by Australian law as low tax jurisdictions. This means that Australia's current law has a mechanism by which certain types of foreign income derived by, or attributed to, Australian residents is taxed as it accrues rather than when it is repatriated.
- There is active oversight and review of the Australian tax system by Parliament, Treasury, the Board of Taxation and the ATO.
- The ATO is held accountable by the Joint Committee of Public Accounts and Audit and a number of oversight bodies, including the Inspector General of Taxation.
- A comprehensive regime exists that governs tax advice and advisors generally. The registration regime introduced by TASA [Tax Agent Services Act] requires that individuals be 'fit and proper' persons to provide tax advice. This legislation supplements the existing professional obligations for accountants under the Chartered Accountants regime and the obligations of legal practitioners under the various state Legal Profession Acts. This is augmented with specific provisions such as the Promoter Penalty provisions in the Tax Administration Act 1953 (Cth). The registration of tax agents and the enforcement of a legislative code of conduct in TASA ensures that the standards required (and enforced by the Tax Practitioners Board) of an Australian tax advisor are markedly more stringent than in most comparable countries.[76]

3.103 It is unclear, however, whether recent changes have achieved their intended purpose. CPA Australia contended in relation to the 2013 amendments to strengthen the general anti-avoidance provisions and modernise the transfer pricing provisions that:

> …neither of these pivotal amendments have been tested judicially, and thus their potential scope and reach is not yet sufficiently understood.[77]

3.104 More recently, the government has announced additional unilateral measures in the 2015–16 Budget to further combat base erosion and profit shifting by multinational corporations. Specifically, it seeks to do this by again strengthening the general anti-avoidance rules, and facilitating a more level playing field for domestic corporations to compete with multinationals. Nonetheless, evidence before the committee indicated that there is much scope for further refinement of tax legislation to contain base erosion and profit shifting.

3.105 The committee is encouraged by these announcements and considers that the actions arising from the OECD's BEPS initiative will provide opportunities to further

76 *Submission 91*, pp. 3–4.

77 CPA Australia, *Submission 73*, p. [2].

strengthen the system. These initiatives and unilateral alternatives are further explored in chapters 4 and 5.

Chapter 4

Multilateral initiatives to address avoidance and aggressive minimisation

Overview of the multilateral tax reform initiative

4.1 The opportunities for aggressive tax minimisation and avoidance have grown commensurately as the relative importance of global trade and multinational corporations has risen. According to the OECD, WTO and World Bank Group, over 70 per cent of global trade today is in intermediate goods, services and capital goods.[1] Indeed, the OECD considers that:

> The growth of MNEs [multinational enterprises] presents increasingly complex taxation issues for both tax administrators and the MNEs themselves since separate country rules for the taxation of MNEs cannot be viewed in isolation but must be addressed in a broad institutional context.[2]

4.2 The international tax architecture was developed over 50 years ago and has been a critical driver of economic growth globally by providing the certainty and stability needed to encourage long-term international trade and investment.[3] The OECD has led the development of these international tax standards through:

- promulgating the rules guiding the standards, namely the OECD Model Tax Convention and the Transfer Pricing Guidelines;
- developing instruments to support cross-border cooperation, such as the Model Tax Information Exchange Agreement and the multilateral Convention on Mutual Administrative Assistance in Tax Matters; and
- combating tax evasion by establishing and promoting the international standards on Exchange of Information 'on request' (EOI) and, more recently, the Standard on Automatic Exchange of Information (AEOI).[4]

4.3 While the OECD's efforts in tax reform were originally focused on eliminating double taxation (that is, paying tax in both the source and residence countries) arising from cross border investment, more recently the converse issue of double non-taxation (that is, not paying tax in either the source or residence countries) has emerged. As Mr Pascal Saint-Amans from the Centre of Tax Policy and Administration, OECD, described:

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1 *Global Value Chains: Challenges, Opportunities, and Implications for Policy*, Report prepared for submission to the G20 Trade Ministers Meeting, Sydney, Australia, 19 July 2014, p. 7.

2 OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrators*, July 2010, p. 17.

3 Business Council of Australia, *Submission 87*, p. 12.

4 OECD, *Submission 85*, p. 1.

> …in many countries there have been growing concern[s] about double non-taxation, seeing how companies in a globalised environment have been able to legally—or, most often, legally—plan their tax affairs in quite an aggressive way which has reduced their tax burden to something which is very different from the nominal tax rates in different countries. This is a worldwide phenomenon that we in the OECD have quantified as base erosion and profit shifting.[5]

4.4 As governments have become increasingly aware that international tax laws have not kept pace with the increased interconnectedness and digitisation of the modern global economy, there has been a more concerted effort to work collaboratively to progress tax integrity reforms. According to the Business Council of Australia:

> International tax laws are either not robust enough or mismatches have emerged, and there has been a growing importance of different types of assets, such as intangibles (e.g. patents and trademarks). There is also genuine difficulty and complexity in determining where profits are sourced—reasonable minds can disagree.[6]

4.5 More broadly, the OECD outlined the reasons why tax concerns are at the forefront of the international political agenda:

> In recent years, the onset of the global financial crisis and slowing economic growth was coupled with perceptions of rising inequality and a lack of fairness. Society was asked to bear the burdens of higher taxes and reduced public spending, while there was a growing awareness that some multinational businesses paid very low levels of taxation on their global profits, including some that received taxpayer-funded bailouts. In this environment, the demand to reform the international tax system and the importance of the OECD's work on tax has reached the top of the international political agenda.[7]

4.6 Reflecting this ongoing concern, the G20 commissioned the OECD to undertake a comprehensive review of the international tax architecture and develop policy proposals to modernise global tax laws ensuring they remain fit-for-purpose and support continued trade, investment and growth.[8]

4.7 The OECD-G20 Base Erosion and Profit Shifting (BEPS) Project was launched in 2013 after an OECD report, *Addressing Base Erosion and Profit Shifting*, outlined global developments that affect corporate tax matters. The report also identified the key principles that should underpin the taxation of cross-border activities, as well as the BEPS opportunities that these principles may create.[9]

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5 *Committee Hansard*, 9 April 2015, p. 59.

6 *Submission 87*, p. 12.

7 OECD, *Submission 85*, p. 1.

8 Business Council of Australia, *Submission 87*, p. 12.

9 OECD, *Submission 85*, p. 1.

4.8 The OECD describes the BEPS Project as:

> …aimed at reforming international tax rules to realign taxation of profits with the underlying economic activities and value creation. This means addressing the loopholes and mismatches in the rules and between domestic tax systems which allow multinationals, legally in most cases, to move profits to low or no tax jurisdictions where little real economic activity takes place.[10]

4.9 The project initially brought together 44 countries—all 34 OECD countries and 10 BEPS associates (the non-OECD G20 countries, and Columbia and Latvia). Since January 2015, a further group of countries have been integrated into the project bringing the total to 62 countries that are involved in meetings of the decision making body or technical working groups. Together, these countries represent over 90 per cent of the world economy.[11]

4.10 Australia has been heavily involved in the BEPS Project through hosting the G20 meeting in 2014 and ongoing engagement by the ATO and Treasury.[12] Mr Economics Legislation Committee, Saint-Amans noted that:

> As chair of the G20, Australia has been a mentor of that [BEPS] project. Your Prime Minister, your Treasurer, were instrumental in putting very high on the agenda the BEPS discussions during the G20…Australia has been absolutely involved in all working groups.[13]

4.11 Professor Kerrie Sadiq highlighted the leadership role that Australia has and will continue to have in developing and implementing the BEPS actions:

> …it will be a case of sovereign nations adopting the recommendations out of the OECD BEPS project and countries like Australia entering into multilateral convention, altering tax incentives or enacting domestic legislation. This is where Australia must be proactive in adopting OECD BEPS recommendations and has the opportunity to show leadership within the region.[14]

The BEPS Action Plan

4.12 In 2013, the OECD released a comprehensive 15 point action plan to address the most important elements contributing to base erosion and profit shifting (BEPS). The areas covered by the action plan are intended to:

1. address the challenges of the digital economy;
2. neutralise the effects of hybrid mismatch arrangements;
3. strengthen rules on Controlled Foreign Companies (CFCs);

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10 *Submission 85*, p. 1.

11 OECD, *Submission 85*, p. 2.

12 Mr Rob Heferen, *Committee Hansard*, 9 April 2015, p. 18.

13 *Committee Hansard*, 9 April 2015, p. 61.

14 *Committee Hansard*, 8 April 2015, p. 9.

4. limit base erosion via interest deductions and other financial payments;
5. counter harmful tax practices more effectively, taking into account transparency and substance;
6. prevent tax treaty abuse;
7. prevent the artificial avoidance of permanent establishment (PE) status;
8. assure that transfer pricing outcomes are in line with value creation—intangibles;
9. assure that transfer pricing outcomes are in line with value creation—risks and capital;
10. assure that transfer pricing outcomes are in line with value creation—other high-risk transactions;
11. establish methodologies to collect and analyse data on BEPS and the actions to address BEPS;
12. require taxpayers to disclose their aggressive tax planning arrangements;
13. re-examine transfer pricing documentation;
14. make dispute resolution mechanisms more effective; and
15. develop a multilateral instrument capable of implementing the tax treaty-related BEPS measures.[15]

4.13 The plan is designed to ensure the coherence of corporate tax systems in a cross-border environment, introduce substance requirements in the area of tax treaties and transfer pricing, and ensure transparency while promoting certainty and predictability.[16] It is a comprehensive plan for international tax reform that aims to bring countries together so they will be more efficient in addressing aggressive tax planning, rather than taking unilateral measures that might be more disruptive and increase the risk of double taxation.[17]

Progress so far

4.14 The release of the policy proposals is staged over 2 years—known as the 2014 deliverables and 2015 deliverables. The 2014 deliverables were released at the G20 Finance Ministers meeting in September 2014 and cover seven of the action areas. The key outcomes of this first stage, with implementation of the relevant measures by national governments, are:

- hybrid mismatches will be neutralised (Action 2);
- an agreed minimum standard to put an end to treaty shopping and other forms of treaty abuse (Action 6);

15 OECD, *Submission 85*, p. 2.

16 OECD, *Submission 85*, p. 2.

17 Mr Pascal Saint-Amans, *Committee Hansard*, 9 April 2015, p. 59.

- abuse of transfer pricing rules in the key area of intangibles will be minimised (Action 8); and,
- better transparency for tax administrations and more global consistency for taxpayers through improved transfer pricing documentation and a template for country-by-country reporting (Action 13).[18]

4.15 In addition, OCED members and BEPS associate countries agreed that negotiation on implementing tax treaty-related BEPS measures through a multilateral instrument would begin by mid-2015 (Action 15).[19]

4.16 Final agreement on the approach to fight harmful tax practices through intellectual property regimes was reached in January 2015 (Action 5).[20]

4.17 The 2014 deliverables also included a report setting out a common understanding of the tax challenges raised by the digital economy, which will form the basis for extending the work in this area of the economy where BEPS practices can be exacerbated (Action 1).[21]

Work to be completed

4.18 The 2015 deliverables will report on actions that were not addressed in the 2014 deliverables. Accordingly, eight discussion drafts have been issued for public comment and it is anticipated that, despite the tight timelines, all of the 2015 deliverables will be presented as soft law instruments that countries will then be invited to translate into their domestic and legal frameworks as necessary.[22]

4.19 The full package of BEPS measures, agreed by consensus of the OECD members and BEPS associates, will be presented to the G20 Finance Ministers in October 2015, and, in turn, to the G20 Leaders at their meeting in November 2015.[23]

Will multilateral tax reform through the BEPS Project be effective?

4.20 The OECD's ambitious work program to develop multilateral initiatives to address base erosion and profit shifting is generally supported by stakeholders. However, concerns have been raised about: the willingness of countries to support and implement reform; the accelerated timeframe of the plan's development; and the overall effectiveness of the measures proposed.[24]

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18 OECD, *Submission 85*, p. 3.

19 OECD, *Submission 85*, p. 3.

20 OECD, *Submission 85*, p. 3.

21 OECD, *Submission 85*, p. 3.

22 Mr Pascal Saint-Amans, *Committee Hansard*, 9 April 2015, p. 60.

23 OECD, *Submission 85*, p. 3.

24 See, for example, evidence provided by Professor Richard Vann, Professor Kerrie Sadiq and Associate Professor Antony Ting, *Committee Hansard*, 8 April 2015, pp. 9–18.

General support for multilateral tax reform

4.21 The intent and process of the OECD's work towards international tax reform has been strongly supported by government and stakeholders in all participating countries. This initiative has also been guided and supported by a broad range of stakeholders. As the OECD reports:

> Broad stakeholder engagement has been an important factor guiding the BEPS work since the beginning, through the release of discussion drafts, public consultations, and regular live webcasts watched by more than 26 000 people to date. Business, civil society, trade unions and academics have all made significant contributions to the Project and are shaping the solutions to ensure they are appropriately nuanced—striking a balance that addresses the need for effective measures and the risk of excessive compliance burdens.[25]

4.22 Many stakeholders outlined and emphasised the benefits of multilateral action. In the view of Mr Saint-Amans:

> …multilateral action is much more fit for purpose than uncoordinated unilateral actions, for a couple of reasons. One is that unilateral action is much less efficient and effective than multilateral approaches. If you act on your own, it is going to be more difficult to fix the issues than if all the countries act together or all the countries recognise that a number of actions are fit for purpose…
>
> The second element is about keeping the balance between putting an end to double non-taxation—stateless income…—and keeping away from double taxation. The risk of unilateral action is about creating risks for double taxation.[26]

4.23 The Business Council of Australia commented that coordinated multilateral action is important to support trade and investment:

> The OECD's BEPS process is of great importance to Australia as a medium-sized open economy that is heavily dependent on trade and foreign investment.[27]

4.24 The majority of companies that made submissions to the inquiry also offered support for the BEPS process. For example, Transurban submitted that it:

> …encourages Australia to continue its significant involvement with the G20 and the OECD Base Erosion and Profit Shifting project. In particular, Transurban supports this collaboration because it will help ensure that any cross-border tax measures are addressed in a coordinated, multilateral manner with due regard to the economic objectives of the various jurisdictions involved.[28]

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25 *Submission 85*, p. 2.

26 *Committee Hansard*, 9 April 2015, pp. 60–61.

27 *Submission 87*, p. 4.

28 *Submission 55*, p. 7.

4.25 A number of non-government organisations, charities and unions were cautiously supportive of the BEPS initiative. For example, Action Aid Australia submitted that:

> ActionAid Australia recognises the development of the Base Erosion and Profit Shifting (BEPS) process by the G20 and the OECD, to the extent that there is now an existence of some actionable process in place to address the issue of corporate tax avoidance.[29]

4.26 Reflecting the views of many participants to the inquiry, Professor Kerrie Sadiq was optimistic that:

> The work of the OECD BEPS project will hopefully give countries the tools they need to ensure that profits are taxed where the economic activities generating profits are performed and where value is created.[30]

4.27 Treasury outlined the importance of taking a measured approach in relation to the implementation of the BEPS program reforms:

> Any changes need to be well considered to ensure they do not unnecessarily affect legitimate business activity…The risks of overreach are high and Australia simply does not have the luxury of enacting laws that, on the face of them, attempt to deal with tax avoidance but in substance provide legitimate value-creating activity from taking place.[31]

4.28 Similarly, the Tax Institute, CPA Australia, and the Corporate Tax Association, supported the OECD's work but urged the committee not to act in haste and pre-empt the outcomes and impacts of the BEPS process.[32]

4.29 Despite Australia's cautious approach to introducing the BEPS measures so far, the government has announced a number of measures to commence implementation of four of the key actions arising from the 2014 deliverables—Country-by-Country reporting; treaty abuse rules; anti-hybrids rules; and, harmful tax practices and exchange of rulings.[33] The potential role of Country-by-Country reporting in assisting tax administrators is explored in chapter 6.

Concerns about the BEPS initiative

4.30 While most stakeholders agree that it is worth waiting for the full package of BEPS deliverables to be presented and for countries to take coordinated action in line with the action plan, many also indicated that it might be worthwhile to explore unilateral initiatives in parallel with the development of the BEPS measures.

4.31 Some stakeholders were concerned that countries would thwart the implementation of the BEPS program by refusing to implement the agreed action

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29 *Submission 67,* p. [2].

30 *Committee Hansard*, 8 April 2015, p. 9.

31 Mr Robert Heferen, *Committee Hansard*, 9 April 2015, p. 18.

32 *Submission 33*, p. 5; *Submission 73*, p. [2]; *Submission 59*, p. 13.

33 Australian Government, *Fairness in Tax and Benefits*, Budget 2015–16, p. 8.

plans. Professor Richard Vann noted the risks associated with relying on countries to implement multilateral actions and that the previous attempt to undertake significant international tax reform through the OECD Harmful Tax Competition project was limited when the US stopped supporting it in 2001.[34]

4.32 In this regard, it should be noted that, in contrast to previous attempts at international tax reform, the full package of measures resulting from the BEPS project will include minimum standards to which countries should commit. As described by Mr Saint-Amans:

> What we are going to present are soft law instruments that will include minimum standards that countries will have committed to, and then countries will be invited to translate these into their domestic legal and regulatory frameworks as necessary.[35]

4.33 Associate Professor Antony Ting contended that resistance to transfer pricing reforms may be indicative of a larger problem:

> As transfer pricing is often at the core of most BEPS structures, the ideal solution is to fix the transfer-pricing rules on an international consensus basis. The OECD BEPS project has been trying to do that since 2013; however, the experience so far is not encouraging. Even modest proposals to reform the current transfer-pricing rules have been subject to fears and objections from business and tax professionals.
>
> The fact that some countries do not seem to be wholeheartedly supporting that BEPS project worsens the situation. Research has revealed that the US has been knowingly facilitating these multinationals to avoid foreign taxes. Furthermore, the objective of this involvement in the BEPS project seems to be to undermine the project. If we accept this reality, what can Australia do? It may be worthwhile to consider second-best solutions.[36]

4.34 Responding to concerns that countries may try to frustrate the implementation of BEPS, Mr Saint-Amans highlighted that:

> …if one country were to block the others from moving ahead, as countries are sovereign, what is going to happen is that countries will take unilateral measures, which will globally be detrimental to the tax affairs of the companies of the other countries. So it is a cooperative game.[37]

4.35 Even though the full set of BEPS deliverables will be presented in October 2015, it may take some time for these actions to be adopted and translated into law by participating countries. In the view of the Business Council of Australia:

> The BEPS project will take time due to the complexity and multilateral approach, but also in part because each country confronts the challenge

34 *Committee Hansard*, 8 April 2015, p. 10.

35 *Committee Hansard*, 9 April 2015, p. 60.

36 *Committee Hansard*, 8 April 2015, p. 11.

37 *Committee Hansard*, 9 April 2015, p. 62.

> from a different starting point. This includes the sophistication of existing domestic tax systems, level of compliance, and structure of economies.[38]

4.36 While supporting the intent of the BEPS program, some stakeholders implored the committee to consider the national interest. For example, Transurban contended that Australian companies should not be disadvantaged:

> …Australia's policy on these matters [cross-border tax measures] should always be to not disadvantage complying Australian companies and to ensure that the tax environment promotes economic growth and productive investment.[39]

4.37 Although the accelerated nature of the BEPS process seeks to ameliorate the need for countries to take unilateral action, it has the potential to result in unintended consequences and actions that were not foreseen during development. For example, the Uniting Church of Australia, Synod of Victoria and Tasmania, highlighted an apparent shift in aim of the project early on:

> The Synod shares the concern of the BEPS Monitoring Group that the OECD in the BEPS Action Plan has drifted from the G20 aim of 'Profits should be taxed where the economic activities deriving the profits are performed and where value is created', to the elimination of 'double non-taxation'. The shift is important as the OECD goal can be achieved by simply ensuring all profits are taxed somewhere, but that somewhere would not have to be in the place where the economic activities deriving the profits are performed and where value is created.[40]

4.38 This shift in focus may lead to actions that are not in the national interest of some nations and make it even more important for countries to have the option of taking unilateral action so they are not disadvantaged by the proposed reforms.

Committee view

4.39 The committee considers that the efforts of the OECD in addressing problems associated with base erosion and profit shifting are worthwhile. The Australian Government should continue to support fully the development and timely implementation of the actions that arise from this initiative.

4.40 The committee appreciates the risks to Australia's corporate revenue base posed by the current international tax system and the efforts of the OECD to address issues related to base erosion and profit shifting through the BEPS project. It acknowledges that this project will not be completed until later in 2015 and is encouraged by progress to date.

4.41 Accordingly, the committee considers that it is appropriate for the Australian Government to continue to support and contribute to the BEPS project and other initiatives by the OECD (such as automatic exchange of information) so that

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38 *Submission 87*, p. 13.

39 *Submission 55*, p. 7.

40 *Submission 74*, p. 170.

coordinated, multilateral action on international tax reform can help restore the integrity of international tax systems and enhance Australia's revenue base.

4.42 However, in the case that a coordinated response fails to materialise in an acceptable timeframe, the Australian Government should reserve the right to act unilaterally to address identified shortcomings in the taxation of multinational operations.

Recommendation 2

4.43 The committee recommends that the Australian Government continue to take a leadership role in finalising and implementing the efforts of the OECD in addressing problems associated with base erosion and profit shifting. However, the committee also considers that international collaboration should not prevent the Australian Government from taking unilateral action.

Chapter 5

Potential areas of unilateral action to protect Australia's revenue base

5.1 This chapter explores the potential for Australia to undertake unilateral tax reform in specific areas that either will not undermine the work of the BEPS program or are not within scope of the OECD work. As this is only an interim report, the chapter does not explore all the areas of unilateral action that the committee considers are important.

Scope for unilateral action

5.2 As noted in the previous chapter, the committee supports the efforts of the OECD in developing a coordinated response to base erosion and profit shifting. However, Mr Saint-Amans highlighted one of the major shortcomings of the BEPS program:

> Countries are sovereign, so what is agreed at the OECD is morally binding but it is not legally binding.[1]

5.3 Consistent with this, the Treasury scoping paper, *Risks to the Sustainability of Australia's Corporate Tax Base*, noted that:

> There are some actions Australia can and has taken unilaterally; these are primarily focused on improvements that can be made without significant divergence from international tax settings.[2]

5.4 As such, there may be value in Australia proactively continuing to identify potential risks to the integrity of the corporate tax system and take assertive actions to address these risks. Indeed, Associate Professor Ting contended that it is unlikely that the BEPS project will be a complete success:

> …while Australia should continue its support of the OECD's BEPS Project which strives to achieve international consensus on solutions to address BEPS issues, it is doubtful if the Project will be a complete success. Therefore, Australia should consider appropriate unilateral actions to complement the international effort.[3]

Risks associated with unilateral action

5.5 A number of stakeholders warned the committee about the risks associated with taking unilateral action to address base erosion and profit shifting before the

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1 *Committee Hansard*, 9 April 2015, p. 64.

2 Treasury, *Risks to the Sustainability of Australia's Corporate Tax Base*, Scoping Paper, July 2013, p. 45.

3 *Answers to questions on notice received from Associate Professor Antony Ting*, 23 April 2015, p. 2.

finalisation of the BEPS project. For example, the Corporate Tax Association contended that Australia risks compromising its commodity revenue base if tax reform is not coordinated.

> Taking unilateral action invites reprisals and risks double tax outcomes, which is highly inimical for investment and jobs…
>
> Changing the source/residency rules in a more co-ordinated way would be far preferable, albeit challenging as it would essentially involve a negotiation between nation states over taxing rights. Australia in particular would need to tread carefully in case it jeopardises its revenue base relating to our huge volumes of commodity exports.[4]

5.6 The Business Council of Australia reflected on the potential effect of unilateral action on a coordinated response:

> Unilateral action outside of the BEPS project may encourage other countries to act alone and splinter international taxation norms, risking unintended consequences including double taxation and distortion of genuine commercial activity.[5]

5.7 Unilateral actions may not necessarily conflict with the BEPS program where they are outside the program's scope or where the proposed BEPS actions do not align with the problems facing Australia's corporate tax regime.

5.8 Australia has progressively strengthened its tax regime in a number of areas targeted by the BEPS project and these initiatives may not require substantial changes to bring them into line with the proposed BEPS actions. Mr Andrew Mills, Second Commissioner of the ATO, has noted the strength of Australia's corporate tax laws in relation to some of the BEPS action areas:

> Because of changes over recent years we [Australia] have probably the strongest anti-avoidance and transfer pricing rules in the world.[6]

5.9 A number of companies compared the strength of Australia's tax regime favourably with other jurisdictions in relation to multinational activities. For example, Brambles submitted that:

> …Australian tax laws are among the most stringent laws in the world, having regard to comprehensive rules on controlled foreign companies ('CFC's'), transfer pricing and anti-avoidance, thin capitalisation, debt vs equity, to name a few examples.[7]

5.10 These sentiments were echoed by BHP Billiton which considered that:

> …Australia comes to the international policy debate with a comprehensive suite of laws to safeguard the integrity of Australia's corporate tax system. These laws include general anti-avoidance rules, specific anti-avoidance

4 *Submission 59*, p. 11.

5 *Submission 87*, p. 5.

6 Economics Legislation Committee, *Estimates Hansard*, 22 October 2014, p. 149.

7 *Submission 68*, p. 2.

> rules, transfer pricing, thin capitalisation and controlled foreign company rules…
>
> Australia's controlled foreign company rules aim to prevent erosion of the Australian tax base through shifting income to jurisdictions that do not impose tax or that impose tax at low rates. Together the rules act as a deterrent to taxpayers engaging in unacceptable corporate tax avoidance.[8]

5.11 It also observed that during 2013, Australia had:

- strengthened its general anti-avoidance rules and specific anti-avoidance rules which are now considered amongst the most rigorous in the world; and
- made significant amendments to reinforce Australia's rigorous transfer pricing and thin capitalisation rules.[9]

5.12 While Australia has considerably strengthened rules around transfer pricing, debt loading and thin capitalisation, more can be done in the design of the tax system governing multinational corporations to reduce the opportunities for tax avoidance and tax planning arrangements that are not in keeping with the intention of Australia's tax laws. The committee notes the proposals announced as part of the 2015–16 Budget to implement some of the more advanced BEPS action items and the introduction of unilateral measures to counter the avoidance of permanent establishment.

5.13 That said, the committee was also presented with information that indicated some aspects of the corporate tax system could be strengthened without jeopardising multilateral efforts. The areas where the committee envisages scope for the Australian government to take unilateral action are:

- improving public transparency;
- addressing permanent establishment issues; and
- removing tax competition that disadvantages Australian businesses.

Improving public transparency

5.14 During the course of the inquiry, the committee was surprised to learn how little is known publicly about the potential size and scope of the aggressive tax minimisation measures and tax avoidance schemes used by large Australian corporations and multinationals operating in Australia. It was also taken aback by the reluctance of some companies to disclose information to the committee, or, of greater concern, where some companies seemed not to be in possession of what seemed important information about their company's operations in other countries.

5.15 Indeed, one of the main difficulties the committee faced was gathering and making sense of the information about business activities and tax obligations. This paucity of information meant that the committee was unable to determine the extent to which tax avoidance was a problem and what needed to be done to address it.

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8 *Submission 81*, p. 2.

9 *Submission 81*, p. 2.

Moreover, Treasury, as the main policy advice agency in this area, indicated in relation to base erosion and profit shifting that:

> This is a huge issue for us. As to how big an issue and to putting a figure on it, we just do not know.[10]

5.16 It is apparent that there are risks to the integrity of the tax system as a result of the changing composition of the economy and the increasing importance of multinational companies in delivering products and services. It is not apparent, however, the extent to which aggressive minimisation and avoidance are reducing the corporate tax revenue base.

5.17 There is no doubt that public confidence in multinational corporations 'paying their fair share' of tax would be increased by greater public transparency of financial information. Indeed, it may be the case that pubic exposure would put pressure on companies to conduct their affairs with regard to their public reputation. The Uniting Church of Australia, Synod of Victoria and Tasmania, highlighted research that indicated many companies were concerned about reputational risk associated with non-compliance with tax laws.[11]

How much is too much?

5.18 It can be difficult getting the balance right between public provision of information and ensuring that commercial operations are not jeopardised by the release of sensitive information.

5.19 The issue of how much information about companies' activities and tax obligations should be available in the public domain was fiercely debated, particularly at hearings. At stake is the right of corporations to have commercially sensitive information remain private versus the right of the public to be able to scrutinise a corporation's tax affairs.

5.20 Making more information available for public scrutiny is necessary to build and maintain confidence and trust in the integrity of the tax system among the broader community. By doing so, these actions would be a means to promote greater levels of compliance across all taxpayers where it could be seen that everyone was 'paying their fair share' and those that were not could be named and subject to the court of public opinion.

5.21 Greater transparency may also help to reduce the confusion surrounding corporate tax. As Mr Herefen explained to the committee:

> It is important that the community is well informed because we are dealing with complex issues that are easily confused.[12]

5.22 The committee would like to acknowledge the efforts of companies that publicly report the amount of tax paid in the jurisdiction where they operate. For

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10 Mr Rob Heferen, *Committee Hansard*, 9 April 2015, p. 25.

11 *Submission 74*, pp. 4–5.

12 *Committee Hansard*, 9 April 2015, p. 18.

example, Rio Tinto produces an annual report on taxes paid by tax type and jurisdiction. According to Mr Chris Lynch, Chief Financial Officer of Rio Tinto:

> Tax transparency…assists the fight against corruption and enhances the scope for communities and citizens to hold their governments to account.[13]

5.23 The committee, however, is dismayed by the ingenuity shown by some companies in avoiding answering questions posed by the committee. This reluctance verged on contempt for the committee process, exhibited disdain for Australian taxpayers and overall reflected poorly on those particular companies. There can be no doubt that transparency in the reporting of information relating to tax practices needs to be improved dramatically.

Recent initiatives to improve public disclosure

5.24 The committee notes that successive governments have been working toward increasing the public disclosure of company's tax information.

5.25 Legislative amendments were enacted in 2013 requiring the ATO to annually publish certain taxpayer information—name, Australian Business Number, total income, taxable income and tax payable—for large corporate entities with turnover of greater than $100 million in a financial year. The amendments were intended to discourage large corporate entities from engaging in aggressive tax practices and provide more information to inform public debate about tax policy.[14] The first report is due to be released in late 2015.

5.26 The committee notes that Treasury began a consultation process in June on an exposure draft to introduce a Bill to exempt private companies from this reporting regime,[15] but that this proposal has not been supported by evidence provided to the inquiry. The Uniting Church of Australia, Synod of Victoria and Tasmania supplementary submission states that:

> …a document obtained from the Australian Taxation Office (ATO) under freedom of information has revealed that the private companies linked to Australian high wealth individuals have average profit margins lower than the other categories of companies (foreign owned and Australian publicly listed) in the group that the legislation applies to. Almost half of these companies are foreign-headquartered and two-thirds have some form of international related party dealings. They account for most of all international related party dealings reported to the ATO, despite being only 21 per cent of the businesses caught under the tax transparency measures of

13 Rio Tinto, *Taxes Paid in 2013*, p. 1.

14 ATO, *Tax secrecy and transparency: administrative arrangements for reporting entity information—ATO consultation paper*, March 2015, https://www.ato.gov.au/General/Consultation/What-we-are-consulting-about/Papers-for-comment/Tax-secrecy-and-transparency--administrative-arrangements-for-reporting-entity-information---consultation-paper-March-2015/ (accessed 16 June 2015).

15 Treasury, *Better Targeting the Income Tax Transparency Laws*, http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2015/Better-targeting-the-income-tax-transparency-laws (accessed 13 August 2015).

> the *Tax Laws Amendment (2013 Measures No. 2) Act*. It is possible that the lower average profit is simply due to this category of companies performing worse on average than other categories of businesses. However, there is the possibility that the lower average reported profitability is due to aggressive tax practices.[16]

5.27 The committee considers that the relatively basic information which will be released by the ATO is a good first step to facilitating greater transparency and public awareness of corporate tax issues. That said, the turnover threshold could be reviewed after the first report is released with a view to adopting a lower threshold.

5.28 In addition, a public tax transparency code for large corporates was announced in the 2015–16 Budget. The development of this voluntary corporate disclosure code is being led by the Board of Taxation. According to the Treasurer, the Hon. Joe Hockey:

> The actions of a few high profile companies, particularly large multinationals engaging in aggressive tax avoidance, have tarnished the reputations of companies that are doing the right thing…
>
> The Government would like more companies to publicly disclose their tax affairs so as to highlight companies that are paying their fair share and to encourage companies not to engage in tax avoidance.[17]

5.29 The government has indicated that it will monitor the development and adoption of the code and will consider further changes to the law, if required.[18]

5.30 The committee recognises that companies may seek to delay the development and implementation of the public transparency code, or may simply refuse to comply where it is not in their interests. Rather than spending the next two years developing a voluntary disclosure code, the committee considers that the wider community has a right to know about tax affairs of all corporations operating in Australia.

Recommendation 3

5.31 The committee recommends that a mandatory tax reporting code be implemented as soon as practicable but no later than the current timeframe for the proposed voluntary public transparency code. Any Australian corporation or subsidiary of a multinational corporation with an annual turnover above an agreed figure would be required to publicly report financial information on revenue, expenses, tax paid and tax benefits/deductions from specific government incentives, such as fuel rebates and research and development offsets.

Recommendation 4

5.32 The committee recommends maintaining existing tax transparency laws which apply to both private and public companies.

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16 *Supplementary Submission 74*, p. 1.

17 *Consultation on tax integrity proposals*, Letter to Mr Michael Andrew, 12 May 2015.

18 Australian Government, *Fairness in Tax and Benefits*, Budget 2015–16, p. 8.

Increasing disclosure around tax disputes

5.33 In response to widespread concerns about the lack of transparency in disputes, a number of additional proposals to increase transparency were put forward to the committee. Increasing transparency, it was argued, would enable public scrutiny and potentially make some corporations consider the potential effect on their reputation before engaging in tax planning practices.[19]

5.34 Some participants urged the committee to adopt mandatory public reporting of significant tax disputes between the ATO and large corporations. For example, United Voice highlighted that:

> The lifting of privacy protections for corporations once a tax dispute is large enough to have a significant budgetary impact has the potential to deter tax avoidance practices. At some point, public interest concerns must override the privacy of corporate information.[20]

5.35 It went on to recommend that an automatic trigger be introduced so that the ATO was obliged to name companies who are under investigation for tax minimisation practices where the amount in dispute was in excess of $100 million. Doing so would put the onus back on the companies to satisfy the community that they were conducting their activities in a manner that was consistent with community expectations.[21]

5.36 Concerns were also raised about the dispute settlement process and the tendency for disputes to be settled for much less than was originally claimed. United Voice proposed that:

> …the ATO should be required to disclose in a public register those corporations who have agreed to settlements valued at over $5 million. A register would allow the public to see which companies had potentially breached Australian tax laws and to what extent. The disclosure of these corporations would be another deterrent to aggressive tax practices.[22]

5.37 United Voice highlighted that the ATO already publishes Private Binding Rulings but maintains the anonymity of the companies involved. Even if a similar approach were applied to the release of information about settlements, it would still allow for a greater level of transparency and public understanding about the process.[23]

5.38 The committee notes widespread concern in submissions about the lack of transparency concerning disputes between the ATO and large taxpayers and considers that improving public transparency is of utmost importance. The committee also notes

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19 See, for example, Community and Public Sector Union, *Submission 14*; United Voice, *Submission 78*; and Uniting Church of Australia, Synod of Victoria and Tasmania, *Submission 74*.

20 *Supplementary Submission 78*, p. 3.

21 *Supplementary Submission 74*, p. 3.

22 *Supplementary Submission 74*, p. 3.

23 *Supplementary Submission 74*, p. 3.

that no evidence was presented to the inquiry suggesting private companies engage in less corporate tax avoidance than publicly-listed companies.

Recommendation 5

5.39 The committee recommends establishing a public register of tax avoidance settlements reached with the ATO where the value of that settlement is over an agreed threshold.

Recommendation 6

5.40 The committee recommends that the government consider publishing excerpts from the Country-by-Country reports, and suggests that the government consider implementing Country-by-Country reporting based closely on the European Union's standards.

Informing parliament of shortcomings in the corporate tax system

5.41 The committee considers that the steps taken by both the current and former governments have the potential to improve transparency and public awareness about corporate tax. But the committee is concerned that parliament is not being afforded much of the information necessary to determine whether the integrity of the corporate tax system is being compromised, to what extent it is a problem and how it might be best addressed. This point was articulated by Mr Martin Lock:

> Arguably, it is Parliament's business to know how its enacted laws are working or not working, but despite legislation requiring the Commissioner to report annually to Parliament 'on the working of this act' his annual reports are essentially devoid of any information on the tax plans and schemes corporates and multinationals use to exploit tax laws…
>
> Secrecy over settlements raises very serious accountability and transparency issues…complete secrecy over settlement is unnecessary, denying Parliament valuable information it could otherwise use to decide how effectively its enacted laws are working.[24]

5.42 In the interests of enhancing the integrity of the tax system and maintaining community confidence, the committee considers it appropriate for the ATO and Treasury to publish an annual report on the aggressive tax minimisation activities of domestic and multinational corporations.

5.43 As part of this process, a robust methodology should be developed to provide a framework for assessing the size and scope of the problem which could subsequently be refined as more data and information becomes available.

5.44 Initiatives to facilitate greater exchange and transparency of tax information and data both domestically and internationally have the potential to enable tax authorities and policy makers to estimate foregone revenue. In addition, the development and dissemination of such information can bolster public confidence of

24 *Submission 56*, pp. 5, 8.

the integrity of the corporate tax system and, as a result, continue to support relatively high rates of voluntary compliance.

Recommendation 7

5.45 The committee recommends that the ATO, in conjunction with Treasury and other relevant agencies, provide an annual public report on aggressive tax minimisation and avoidance activities to be tabled in Parliament. This report could include estimations of forgone revenue, evaluate the effectiveness of policy and propose potential changes.

Addressing the avoidance of permanent establishment status

5.46 The avoidance of permanent establishment (PE) status is specifically targeted in Action 7 of the BEPS Action Plan. It states that Action 7 is intended to develop:

> …changes to the definition of PE to prevent the artificial avoidance of PE status in relation to BEPS, including through the use of commissionaire arrangements and the specific activity exemptions. Work on these issues will also address related profit attribution issues.[25]

5.47 Although permanent establishment and harmful tax practices are action areas targeted by the BEPS program, some governments have decided that it is an issue important enough to implement unilateral measures in advance of the final BEPS actions being revealed.

Diverted profits tax (UK)

5.48 The Government of the United Kingdom (UK Government) announced plans in December 2014 to take unilateral action though the introduction of a diverted profits tax. According to HM Revenue and Customs, the diverted profit tax legislation is aimed at:

> Large multinational enterprises with business activities in the UK who enter into contrived arrangements to divert profits from the UK by avoiding a UK taxable presence and/or by other contrived arrangements between connected entities…
>
> The main objective of the diverted profits tax is to counteract contrived arrangements used by large groups (typically multinational enterprises) that result in the erosion of the UK tax base.[26]

5.49 The diverted profits tax will apply if either:

- foreign companies are deemed to exploit permanent establishment rules; or
- companies create tax advantages by using transactions or entities that lack economic substance.[27]

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25 OECD, *BEPS Action 7: Preventing the Artificial Avoidance of PE Status*, Revised Discussion Draft, 15 May 2015 – 12 June 2015, p. 1.

26 HM Revenue and Customs, *Diverted Profits Tax*, Consultation Draft, 10 December 2014, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/385741/Diverted_Profits_Tax.pdf (accessed 6 May 2015).

5.50 The legislation was passed in March 2015—just before the tax was due to come into effect on 1 April 2015.

5.51 Rather than raise revenue, Professor Vann submitted that the purpose of the diverted profits tax was to change the behaviour of multinationals:

> The hope in the UK is that the diverted profits tax will collect exactly nil because Google will set up an office in the UK and pay ordinary corporate tax. The diverted profits tax is set at 25 per cent. The UK corporate rate is 20 per cent. The idea is that companies will give up their tax planning and just bring themselves into the system and pay the ordinary corporate tax.[28]

5.52 Associated with the underlying motive to change behaviour, the design of the diverted profits tax is such that it may not be supported by international treaties. As a result, corporations that incur the diverted profits tax may not have rights under tax treaties to seek relief from double taxation, thereby providing an incentive for companies to structure their tax affairs to be covered by the mainstream corporate tax system.[29]

5.53 While it is too early to evaluate the impact of the diverted profits tax, there may be lessons for the introduction of a similar tax in Australia, particularly in designing punitive laws to encourage compliance with the mainstream system.

5.54 Ms Rosheen Garnon, KPMG's National Managing Partner Tax, questioned the efficiency of implementing a unilateral measure designed to push corporations back into the conventional tax system:

> What the UK are doing is they are going through a process of introducing a brand-new tax, all the administration that goes with that, having companies work out their compliance with it, only to be pushing people back into the tax net. To my mind, there is a lot of administration and costs associated with doing that.[30]

5.55 When questioned about unilateral action taken by the UK Government, Mr Saint-Amans indicated that the OECD had sympathy for the need to move:

> …the [UK] government, which has been very instrumental in supporting the BEPS in raising the profile of this project, wanted to show that it was acting very, very quickly—even before the timeline of the BEPS project, which is after a very important electoral date in the UK…
>
> We tend to think that unilateral measures will be better after we have completed the action plan...[31]

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27 HM Revenue and Customs, *Diverted Profits Tax*, Consultation Draft, 10 December 2014, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/385741/Diverted_Profits_Tax.pdf (accessed 6 May 2015).

28 *Committee Hansard*, 8 April 2015, p. 16.

29 Mr Mark Konza, ATO, *Committee Hansard*, 8 April 2015, p. 32.

30 *Committee Hansard*, 9 April 2015, p. 7.

31 *Committee Hansard*, 9 April 2015, p. 65.

5.56 Even though a diverted profits tax was raised as a possibility for Australia following the G20 Leaders Meeting in December 2014, the committee notes that the government has decided not to introduce such a tax.

Strengthening anti-avoidance rules in Australia

5.57 Although strongly supporting measures agreed to as part of the OECD's BEPS program, the Australian Government has taken a different approach to the UK and opted to strengthen the existing anti-avoidance rules. In the 2015–16 Budget Speech, the Treasurer announced his intention to introduce a multinational anti-avoidance law to stop multinationals artificially avoiding a taxable presence in Australia and to force them to pay tax in Australia on profits from economic activities undertaken in Australia.[32]

5.58 Proposed changes to Part IVA of the *Income Tax Assessment Act 1936* were announced in the House of Representatives immediately following the 2015–16 Budget speech and, if enacted, would take effect from 1 January 2016.[33]

5.59 An exposure draft of the proposed legislative amendments has been released and submissions called for by 9 June 2015. Twenty submissions were received, of which three are confidential.

5.60 The proposed amendments seek to extend the general anti-avoidance rule in Part IVA of the existing legislation to negate certain tax avoidance schemes used by large multinational corporations to shift profits to low or no tax jurisdictions. The measure will only apply to 'global groups' that have an annual global revenue that exceeds A$1 billion in the year in which they operated the scheme and where the no or low tax jurisdiction condition is satisfied.[34]

5.61 It is anticipated that, if enacted, the measure would capture approximately 30 large multinational companies that the ATO suspects of diverting profit using artificial structures to avoid a taxable presence in Australia.[35]

5.62 Under the proposed legislation, where a tax avoidance scheme is found to be captured by the measure, the Commissioner of Taxation has the power to apply the tax rules as if the non-resident entity has been making a supply through an Australian permanent establishment.[36] Where a corporation is found to have a scheme that is captured by the measure, penalties of up to 100 per cent of the tax owed plus interest may also be applied in addition to the tax owed.[37]

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32 Australian Government, *Budget 2015: Fairness in Tax and Benefits*, May 2015, pp. 7–8.

33 Tax Laws Amendment (Tax Integrity Multinational Anti-avoidance Law) Bill 2015, Explanatory Memorandum, p. 22.

34 Tax Laws Amendment (Tax Integrity Multinational Anti-avoidance Law) Bill 2015, Explanatory Memorandum, p. 6.

35 Australian Government, *Budget 2015: Fairness in Tax and Benefits*, May 2015, p. 7.

36 Tax Laws Amendment (Tax Integrity Multinational Anti-avoidance Law) Bill 2015, Explanatory Memorandum, p. 5.

37 Australian Government, *Budget 2015: Fairness in Tax and Benefits*, May 2015, p. 7.

5.63 The committee notes that the potential revenue benefits from this measure were not quantified in the Budget papers.[38] When questioned about this at the budget estimates hearing, Minister Cormann indicated that:

> The reason there is no revenue estimate is that it is very difficult to quantify the likely revenue collected, and the government has decided to take a conservative approach.[39]

5.64 It may be that, as with the diverted profits tax in the UK, the intention of the multinational anti-avoidance law is to encourage large multinationals to change their behaviour and structure their activities so that profits from Australian activities are brought into the mainstream tax system and are taxed at the company tax rate. If such a behavioural change occurs, the revenue benefits may not accrue to this measure but broader company tax receipts.

5.65 This intention to change behaviour was confirmed by Mr Olesen, Second Commissioner of the ATO, at the budget estimates hearing in June:

> The other thing to look out for when there are amendments to Part IVA is how taxpayers change their behaviour. The best outcome from anti-avoidance provisions is that you never apply them because the entities at which they are targeted change their set-ups and structures in ways that mean they are not subject to those provisions. So exactly what the outcomes might be in the long haul will depend a lot on how entities respond to those new provisions.[40]

5.66 As described by Mr Heferen, the mark of success should be measured by behavioural change:

> At the end of the day what will be a mark of success will be the behavioural change from firms as opposed to the ATO actually utilising the new power. Often the success is not in applying the anti-avoidance provisions; the success comes in firms who would otherwise be the target of the anti-avoidance provisions who change their behaviour to pay tax in Australia so it is not triggered. And given the small number of companies that would be effected here we should be able to see that, hopefully, in a relatively short period of time after enactment.[41]

5.67 The proposed legislation, due to be introduced to the Parliament in the Spring Session, will provide the committee with the opportunity to look more closely at the provisions. As such, the committee considers that the bill, when introduced, will be explored in the final report.

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38 Australian Government, *Budget 2015–16: Budget Measures—Budget Paper No. 2*¸ pp. 14–15.

39 Economics Legislation Committee, *Estimates Hansard,* 2 June 2015, p. 42.

40 Economics Legislation Committee *Estimates Hansard,* 2 June 2015, p. 39.

41 Economics Legislation Committee *Estimates Hansard,* 2 June 2015, p. 42.

Competitive disadvantages arising from inconsistent application of tax laws

5.68 The provision of goods and services from overseas jurisdictions raises concerns on both competition and taxation grounds.

5.69 Competition issues arise where an advantage is gained by some foreign and multinational companies that provide services to Australians from outside Australia. As such, domestic corporations can be disadvantaged because foreign companies are not subject to the same tax regime (not just income tax but also GST, payroll tax, et cetera). According to Mr Heferen from the Australian Treasury:

> …if people are operating off a different cost base, and that is tax driven…then prima facie that is a concern.[42]

5.70 The concerns raised by stakeholders generally fell into two categories—those related to the differences in the level of corporate tax paid on profits, and those related to the levying of GST.

5.71 Not only can foreign firms gain a competitive advantage but these actions also have the potential to reduce Australian tax revenue when they avoid permanent establishment and do not contribute to the tax base in the same way as an Australian domiciled company.

Lower rates of corporate tax

5.72 The committee also received submissions highlighting the fact that foreign companies could bid for government and non-government contracts at lower rates than Australian companies because of differences in corporate tax rates.

5.73 While this may not be a concern for corporations that have to act in the best interests of shareholders, it may provide government agencies with an opportunity to show leadership and even the playing field. For example, Macquarie Telecom voiced concerns about technology contracts and sought to neutralise the competitive disadvantage it faces as an Australian taxpayer:

> …we face a perverse situation where the Government, while increasingly concerned on behalf of taxpayers at the avoidance of tax by international technology giants, is in fact providing taxpayers' money to these same companies under these same questionable arrangements…[43]

5.74 It noted that the committee has discussed how consumers in the UK exercised their collective power against Starbucks by boycotting and occupying Starbucks stores until that business changed its conduct.[44] According to Macquarie Telecom:

> …the Government (and concerned businesses) can similarly exercise their buying choices in a way that discourages arrangements that artificially

42 *Committee Hansard*, 9 April 2015, p. 36.

43 *Submission 94*, p. [1].

44 *Submission 94*, p. [2].

> avoid the establishment of a permanent entity in Australia for tax purposes.[45]

5.75 Macquarie Telecom went on to propose to the committee that government agencies should use their purchasing leverage and discretion to discourage the avoidance of Australian company tax. Squiz, an Australian owned and based technology company, noted that:

> As an Australian taxpayer, we operate on an uneven playing field when competing with overseas businesses who have arranged themselves to artificially avoid establishing contracting entities in Australia.[46]

5.76 Squiz supported the proposal put forward by Macquarie Telecom in principle and believed that it would signal the seriousness with which Australia views the issues of tax avoidance.[47]

Levying of GST

5.77 Various stakeholders outlined concerns that GST was not being charged by some companies on goods and services purchased through the internet. For example, Mr Julian Clarke, Chief Executive Officer of News Corp Australia, outlined his concerns about the need for a consistent application of GST in relation to video on demand services and advertising services:

> The playing field is not level when two of the companies, ours [Presto] and the other joint venture [Stan], have to apply the GST to the selling price, whereas a company [Netflix] can walk in from overseas and not have that…
>
> If the GST were applied to them as it is to us, there would be a level playing field. If they choose to have a price cheaper than us given they are paying all the costs, then that is a different decision, but clearly they are not. They have an advantage that is unfair.[48]

5.78 The committee is also aware that some companies sell advertising in Australia but invoice from a foreign jurisdictions and, as such, are not required to charge GST. For example, a small business owner wrote to the committee to highlight that Facebook invoices Australian companies from Ireland and does not charge GST.

5.79 In the 2015–16 Budget, the Australian Government announced that GST will be extended to cross border supplies of digital products and services imported by consumers from 1 July 2017. According to the Budget Papers:

> This measure will result in Australia being an early adopter of guidelines for business-to-consumer supplies of digital products and services being

45 *Submission 94*, p. [2].

46 *Submission 98*, p. [1].

47 *Submission 98*, p. [1].

48 *Committee Hansard*, 8 April 2015, pp. 63, 68.

developed by the Organisation for Economic Cooperation and Development (OECD) as part of the OECD/G20 base erosion and profit shifting project.[49]

5.80 This approach is consistent with that taken by a number of other countries, including Japan, Norway, South Africa, South Korea, Switzerland and member countries of the European Union.[50]

5.81 As this is a GST measure, it will require agreement from the states and territories prior to its implementation, and all revenue raised from the measure will be transferred to the states and territories.

Committee view

5.82 The committee supports efforts to remove disadvantages for Australian companies when competing with foreign-based entities that arise because of differences in taxation between jurisdictions.

5.83 The proposed action of the Australian Government to close GST loopholes is a first step to improving the integrity of the tax system by levelling the playing field. However, the committee considers that more could be done to ensure that domestic companies are not disadvantaged and that taxes on profits earnt from Australian sources are paid in Australia.

5.84 As a role model for the community, the committee considers that the Australian Government should evaluate tenders for the goods and services it procures using a comparable tax benchmark and not disadvantage Australian companies that have higher tax burdens than competitors from other jurisdictions.

Recommendation 8

5.85 The committee recommends that the Australian Government tender process require all companies to state their country of domicile for tax purposes.

Recommendation 9

5.86 The committee recommends mandatory notification by agencies to the relevant portfolio Minister when contracts with a dollar value above an agreed threshold are awarded to companies domiciled offshore for tax purposes.

49 Australian Government, *Budget 2015–16: Budget Measures—Budget Paper No. 2*¸ pp. 20–21.

50 Australian Government, *Budget 2015: Fairness in Tax and Benefits*, May 2015, p. 5.

Chapter 6

Facilitating government agencies to collect corporate tax and protect public revenue

6.1 Within the Australian Government, a number of agencies are involved in the collection of tax revenue, monitoring of company behaviour, and development of corporate tax policy. This chapter explores the performance and capability in relation to the corporate tax system of the Australian Taxation Office (ATO) and the Australian Securities and Investments Commission (ASIC).

Australian Taxation Office

6.2 The ATO is the government agency responsible for collecting Commonwealth tax revenue and monitoring the compliance of companies with their tax obligations. It considers itself to be an active and visible regulator with a well-educated and experienced workforce administering internationally respected law. It works cooperatively with other revenue authorities and makes risk-based decisions about how resources are managed to administer the tax system.[1] As the ATO's overall approach to administering the corporate tax system is based on cooperative compliance to support willing participation, it assists corporations to meet their tax obligations.[2]

6.3 The ATO is attempting to mitigate international and profit shifting risks through a range of activities, including:

- differentiated compliance approaches, such as risk reviews and audits for larger taxpayers and leveraged approaches (for example, project management) for smaller taxpayers;
- marketing and communications activities to provide guidance on the operation of the law to promote voluntary compliance;
- identifying and analysing new, emerging and evolving trends using intelligence from cases, other external sources and other jurisdictions; and,
- providing empirical evidence to government and Treasury when current laws are found to be ineffective or are producing an unintended policy outcome.[3]

6.4 These efforts are being supplemented by programs that focus on specific areas of risk. For example, the ATO's International Structuring and Profit Shifting (ISAPS) compliance program is investigating corporations that have undertaken international restructures or have significant cross-border arrangements.

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1 *Submission 48*, p. 3.

2 *Submission 48*, p. 14.

3 *Submission 48*, pp. 24–25.

The risk differentiation framework

6.5 In order to fulfil its objectives efficiently and effectively, the ATO uses a risk differentiation framework (RDF) to assess the likelihood of each company not meeting its tax obligations and the consequence of potential non-compliance. This approach is consistent with international best practice and ensures that resources and efforts are focused on those taxpayers and issues posing the greatest risk to the tax system.[4]

6.6 The ATO provided the committee with a table of the number of companies assigned to each risk rating over the last 4 years (Table 6.1).[5]

Table 6.1: RDF risk ratings for public and foreign owned corporations

RDF Rating	2011	2012	2013	2014
Higher Risk	13	6	3	1
Key Taxpayer	78	80	58	68
Medium Risk	380	220	242	307
Lower Risk	642	687	602	33 252[6]
Total	**1113**	**993**	**905**	**33 628**

6.7 The number of corporations in the higher risk category has been declining as the ATO increasingly focuses on a 'prevention before correction' approach which seeks to increase early engagement and identify and address risk pre-lodgement. According to Mr Jeremy Hirschhorn, Deputy Commissioner of Public Groups:

> We view the movement of 12 of those taxpayers from Q1 [higher risk] to Q2 [key taxpayer] as a positive, because it was actually a behavioural change from those companies. They started coming to us before the event and talking to us about what they were doing rather than us working out what they had done after the event and trying to investigate.[7]

6.8 In relation to the sole remaining taxpayer considered to be higher risk in 2014, Mr Chris Jordan, Commissioner of Taxation, noted that:

> Historically, this particular taxpayer has made it quite clear that they have not had an interest in being open with us and discussing any of their tax affairs with us prior to doing transactions. I understand that that attitude

4 *Submission 48*, p. 17.

5 *Submission 48*, p. 17.

6 The number of lower risk corporations increased markedly in 2014 due to organisational realignments.

7 *Committee Hansard*, 22 April 2015, p. 15.

> may be changing and there have been approaches to us recently to work with us to get out of that Q1 [higher risk].[8]

6.9 In general, the ATO continually engages with higher risk and key taxpayers to review their tax affairs and seeks to provide certainty on issues and risks as they arise and resolve issues where uncertainty exists.[9]

6.10 For lower and medium risk corporate taxpayers, the ATO's strategy is to influence taxpayers pre-lodgement and to target certain segments of the lower consequence population through guidance, alerts and workshops; monitor taxpayers through macro and micro level analysis; and undertake post-lodgement review and audit activities as required.[10]

6.11 A similar RDF is applied to private companies to provide an initial risk assessment on them to inform the ATO's assurance strategies. Similar to public companies, higher consequence taxpayers and higher risk taxpayers in this group are likely to be subject to increased scrutiny and assurance activities.

Capability and resourcing

6.12 Within the ATO, there are two main business lines that manage income tax issues for corporates. The Public Groups and International (PG&I) business line has responsibility for all publicly listed and international entities. The Private Groups and High Wealth Individuals (PGH) business line has responsibility for private groups with a turnover of greater than $2 million.[11]

6.13 Around 2,700 ATO officers are engaged in work with corporates across these two business lines with PG&I employing around 45 per cent and PGH employing around 55 per cent.[12] It is anticipated that the relative allocation of staffing will change as the operation of specific projects, such as ISAPS compliance program and Project Wickenby,[13] run their course.

6.14 Many of the staff working in the two main corporate business lines have extensive tax experience across a range of public and private sector environments. In response to concerns about staffing in the international area, Mr Jordan contended:

> We have more staff in our international area than ever before who have, on average, more than 12 years' experience, are better qualified and are more engaged. Our international teams are well rounded, with experts who understand the complexity of international dealings and can deal with various aspects of international tax...

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8 *Committee Hansard*, 22 April 2015, p. 15.

9 *Submission 48*, p. 18.

10 *Submission 48*, pp. 18–19.

11 ATO, *Submission 48*, p. 29.

12 ATO, *Submission 48*, p. 30.

13 Project Wickenby is a cross-agency initiative established in 2006 to protect the integrity of Australia's financial and regulatory systems by preventing people from promoting or participating in the abusive use of secrecy jurisdictions.

> I am very proud of the ability, expertise and integrity of the people we have working on our large corporate cases and I am extremely confident of our capability moving forward.[14]

6.15 In light of recent budget reductions and associated staffing redundancies, the committee was concerned about a potential reduction in the capability and performance of the ATO to identify and litigate corporate tax avoidance. For example, the Community and Public Sector Union (CPSU) submitted that:

> The audit team has been hit particularly hard by job losses. The ATO Assistant Commissioner Geoff Leeper told a recent Senate estimates hearing that nearly a quarter of the redundancies so far had come from the audit area.
>
> CPSU members report that this has significantly impacted the ability of the ATO to investigate matters. Quite simply, they report that fewer audits are being conducted (impacting negatively on revenue), and there is reluctance to review and/or audit larger and more complex entities.[15]

6.16 In its submission, the ATO responded by saying:

> While our recent redundancy program reduced staff numbers we have retained high levels of experience and expertise and continue working to develop critical expertise in our staff…It is important to note that redundancies were offered only after assessment of the criticality of positions and in nearly all cases the staff member, their supervisor, and a panel of Senior Executives agreed that the officer had capabilities that were classified as 'non-essential' for business delivery.[16]

6.17 Noting that budget cuts had led to staff reductions, Mr Jordan indicated that the ATO is appropriately targeting risks and allocating resources accordingly:

> What we have done is make sure that we are allocating staff to the areas of the highest interest…So we have got more senior people, we have got more private sector expertise brought in, and we have moved significant senior resources within the ATO into that internationals area, because that is really an area of focus.[17]

6.18 Specifically in relation to the effect of redundancies on the international group, Mr Jordan contended that:

> …any talk that our redundancy program has had an adverse impact on our capability, in our area dealing with public groups, large corporations and internationals, is simply not true.[18]

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14 *Committee Hansard*, 22 April 2015, p. 2.

15 *Submission 14*, p. 8.

16 *Submission 48*, p. 30.

17 *Committee Hansard*, 8 April 2015, p. 30.

18 *Committee Hansard*, 22 April 2015, p. 2.

6.19 Mr Mark Konza, Deputy Commissioner, International, ATO, noted that the significant focus on improving and streamlining internal processes had not compromised the ability of the ATO to carry out its role as an assurer of the corporate tax base:

> We have flattened structures, we have consolidated our teams so that we are more efficient, we have changed our processes. All in all, we have improved the management of our processes so we can stay as effective as we were.[19]

6.20 While staffing has been reduced, including in the international and public groups area, the ATO considered the impact of this had been off-set by the introduction of the 'smarter data' project.

> …we are doing a lot of work in our analytics area because we think that has got a huge leverage potential. They are highly specialised people: they are typically not with a tax background, but a lot of engineering, computer science, software development backgrounds.[20]

6.21 In addition, the ATO has:

- recruited an additional 80 audit, accounting and tax law specialists;
- ensured succession plans are in place for senior roles; and
- focused on building international tax skills to ensure that its capability is not compromised.[21]

6.22 KPMG highlighted that staff numbers are only a part of the capability and resourcing debate:

> The ATO's staffing numbers are only part of the equation. What is equally important is how the ATO uses its resources. Can early engagement with taxpayers make litigation unnecessary? Could better use of data mining and analytics deliver better outcomes at a lower cost? Are the right cases being selected for investigation and/or litigation? Should a matter proceed to court, or would another dispute resolution process be more efficient?[22]

6.23 The committee notes the decline in ATO staffing and resourcing levels in recent Budgets, and the pressure this has put on consolidated revenues, audits and dispute settlements to identify, investigate and prosecute, where necessary, instances of corporate tax avoidance in Australia.

6.24 The committee acknowledges that the ATO has undergone significant structural reorganisation to make the best use of available resources and is currently devoting its efforts into areas likely to prove most beneficial. Nonetheless, the committee considers that it is in the interest of the government and the wider

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19 *Committee Hansard*, 8 April 2015, p. 33.

20 *Committee Hansard*, 8 April 2015, p. 34.

21 ATO, *Submission 48*, pp. 30–31.

22 *Submission 91*, p. 8.

community to ensure that the ATO has sufficient funds to fully and effectively combat tax avoidance.

Recommendation 10

6.25 The committee recommends an independent audit of ATO resourcing, funding and staffing.

Recommendation 11

6.26 The committee recommends the ATO report to parliament, at least annually on:

- **the number of audits or disputes launched concerning multinational corporations;**
- **the number of cases settled with multinational corporations;**
- **the number of successful legal proceedings concluded against multinational corporations; and**
- **the staff resources allocated to tax compliance of multinational corporations.**

Willingness to undertake litigation

6.27 Some stakeholders accused the ATO of seeking to avoid litigation and settle with large corporates. For example, reflecting the experiences of members working in the ATO, the CPSU submitted that:

> Members advised that funding available to litigate matters has been cut, with case officers forced to settle matters that would otherwise see important issues tested in court. Members suggested that, due to the costs involved, there was reluctance within the ATO to prosecute large companies suspected of engaging in tax avoidance because of the duration and complexity of these matters. Members were concerned that settlements potentially cost the ATO significant revenue.[23]

6.28 Mr Jordan spoke of the resources tied up in pursuing just one of the complex tax avoidance allegations that was prosecuted:

> If I could just take one thing that is on the public record it would be the Chevron case, which is very recent, from the end of last year. Not to oversimplify it, basically, there was a borrowing at two per cent by the United States parent and an on-lending at nine per cent. As I understand it, there were something like over 30 expert reports. There were 11 barristers in the case. It took years to get up, and, in my view—maybe I am just too simple here—that looked like a pretty straightforward issue.[24]

6.29 Even so, in response to concerns raised in submissions, he noted in his opening statement to the committee on 8 April 2015 that:

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23 *Submission 14*, p. 9.

24 *Committee Hansard*, 8 April 2015, p. 26.

> Whilst we do look to engage earlier and solve issues more quickly, we will continue to use litigation where there is a need for law clarification or if a message needs to be sent that certain behaviours are simply not acceptable. We will not hesitate to pass on information to the Commonwealth Director of Public Prosecutions and law enforcement agencies, where appropriate.[25]

6.30 According to the ATO, it seeks to identify and resolve potential issues early by offering a range of opportunities for significant (or potentially contentious) corporate tax planning and major transactions to be disclosed. By taking a more collaborative approach and shifting efforts towards early engagement, the ATO has seen a reduction in the number of audit and review cases.[26]

6.31 Other stakeholders, such as PricewaterhouseCoopers, KPMG and the Tax Institute, supported the position of the ATO. For example, KPMG submitted that it:

> …agrees with the many other submissions to the inquiry, which observe that the ATO has long been, and continues to be, a highly regarded tax administrator when it comes to investigating and commencing litigation.[27]

6.32 The committee understands that significant effort is required to develop and prosecute cases involving corporate tax avoidance and acknowledges that, even then, the result may still be uncertain. While the committee realises the ATO is doing what it can with the resources it has available, corporate tax avoidance and aggressive minimisation is potentially the most important risk to Australia's tax base.

6.33 Maintaining the integrity of the tax base is essential and it needs to be done well. Accordingly, the committee considers that sufficient resources need to be provided to enable the ATO to undertake the litigation it deems appropriate.

Ensuring access to relevant information

6.34 While the committee considers that public transparency is vital to maintain confidence in the tax system, it is equally important that tax administrators are able to access the relevant information they require, particularly in relation to the activities of multinational corporations.

6.35 Professor Vann provided the most succinct reason for strengthening transparency—'You cannot tax what you cannot see….'[28]

6.36 Accessing relevant information is an essential component of identifying and investigating aggressive tax planning, avoidance and evasion. The ATO explained that it has difficulties obtaining the information that it needs to undertake its duties in identifying and addressing aggressive minimisation practices:

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25 *Committee Hansard*, 8 April 2015, p. 19.

26 *Submission 48*, p. 34.

27 *Submission 91*, p. 7.

28 *Committee Hansard*, 8 April 2015, p. 17.

> Particularly when you are dealing with international companies, getting information, which often has to be got from their parent or from other jurisdictions using treaty powers, is a frustratingly slow process.[29]

6.37 Strict privacy laws in relation to the use of this information and the need for the ATO to maintain an ongoing relationship with its clients should allay any concerns about the likelihood of confidential information being released into the public domain without authorisation.

6.38 Indeed, the ATO has refused the committee's request to disclose confidential taxpayer information. In this regard, Mr Jordan highlighted that:

> …all taxpayers need to have confidence that confidentiality will be maintained over their taxation and commercial information. Disclosing confidential taxpayer information raises issues for the future for all taxpayers in terms of our ability to facilitate transparency, cooperation and productive relationships with them.[30]

6.39 In addition, the limitations placed on the ability of relevant government agencies to share or exchange information also hinder the ability of the tax office to identify and act on tax avoidance. The success of Project Wickenby—a cross-agency collaboration of 8 agencies to fight against tax avoidance, evasion and crime—illustrates the potential of having similar information sharing agreements on a more permanent basis.

6.40 The committee considers that the ATO should have the capacity to request and receive any useful information that can enable it to identify and investigate corporate tax avoidance and evasion. Where necessary, the ATO should be able to access any further information that it requires from the companies themselves, relevant government and non-government entities (such as ASIC, AUSTRAC, law enforcement agencies, accountants, lawyers and financial institutions) and relevant international jurisdictions.

Country-by-Country reporting

6.41 OECD initiatives, such as the introduction of common Country-by-Country reporting standards and automatic exchange of information, are important and necessary for tax administrators to enable them identify and act on aggressive tax planning.

6.42 Country-by-Country reporting, Action 13 of the BEPS agenda, is intended to provide tax administrators with sufficient information to assess high-level transfer pricing and other BEPS-related risks. [31]

6.43 Multinational enterprises with consolidated group revenue of greater than €750 million (or equivalent in domestic currency) in the previous fiscal year will be

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29 Mr Mark Konza, *Committee Hansard*, 22 April 2015, p. 8.

30 *Committee Hansard*, 8 April 2015, p. 21.

31 OECD, *Action 13: Country-by-Country Reporting Implementation Package*, OECD/G20 Base Erosion and Profit Shifting Project, 2015, p. 5.

required to provide Country-by-Country reports of their activities, including data on revenue, profit and tax paid in each jurisdiction. The OECD considers that this balances the regulatory burden of reporting with the potential benefit to tax administrators as the approximately 15 per cent of multinationals that will be required to report control approximately 90 per cent of corporate revenues.[32]

6.44 Australia will be one of the first adopters of Country-by-Country reporting when it comes into effect on 1 January 2016.

6.45 The committee fully supports the initiatives of the OECD to facilitate the exchange of information between jurisdictions and the early adoption of Country-by-Country reporting. However, the extent to which these measures are effective largely depends on their implementation which is yet to come into effect.

Using international forums to promote dialogue

6.46 In addition to the OECD and its work on base erosion and profit shifting, the ATO is leading a number of international forums to promote greater international collaboration to address multinational tax avoidance. Mr Jordan informed the committee that he had:

> …taken on a role as vice-chair of the OECD Forum of Tax Administration with responsibility for revitalising the JITSIC network, which is the Joint International Tax Shelter Information and Collaboration project. The JITSIC network focuses specifically on tackling cross-border tax avoidance and evasion.[33]

6.47 He explained further:

> … At Australia's instigation, we now have 38 member countries authorities worldwide. We are also cooperating within our own region. Late last year, I established a permanent taskforce with the tax commissioners of 17 jurisdictions from the Asia-Pacific region to actively share compliance tactics and intelligence, and these are very practical steps we can take now while we wait for the OECD to deliver their reform.[34]

6.48 Global collaborations and initiatives to share the detailed information required to identify aggressive tax planning practices operating across jurisdictions should be an imperative for countries, such as Australia, seeking to address harmful tax practices and more appropriately tax revenue at the source of its activity.

6.49 The committee supports the ATO's efforts to work with tax administrators in other jurisdictions to improve collaboration and information sharing between jurisdictions.

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32 OECD, *Action 13: Guidance on the Implementation of Transfer Pricing Documentation and Country-by-Country Reporting*, OECD/G20 Base Erosion and Profit Shifting Project, 2015, p. 4.

33 *Committee Hansard*, 8 April 2015, p. 20.

34 *Committee Hansard*, 8 April 2015, p. 20.

Australian Securities and Investments Commission (ASIC)

6.50 The Australian Securities and Investment Commission (ASIC) is Australia's corporate, markets and financial services regulator. ASIC's fundamental objective is to allow markets to allocate capital efficiently to fund the real economy and, in turn, economic growth.[35]

6.51 ASIC seeks to share information with the ATO to help identify tax avoidance and aggressive minimisation, where permitted by law. Public financial reports filed with ASIC can also provide public information to indicate that a corporation is involved in tax avoidance or has adopted aggressive minimisation strategies.[36]

6.52 ASIC assists the ATO in its role of collecting tax through:

- sharing information that each agency is permitted to share under their respective legislative arrangements;
- cooperating to address issues that are relevant to both agencies through collaborative means, such as working parties; and
- having relationship managers responsible for maintaining the relationship between agencies and dealing with ad hoc issues and requests for information.[37]

6.53 While information is not generally provided proactively, the exchange of information occurs relatively frequently between the two agencies and can facilitate meeting the regulatory mandates of each agency.[38] However, there are limitations on ASIC providing information to the ATO. This is particularly so if the ATO has not sought the information under a Memorandum of Understanding or if the information has been compulsorily acquired by ASIC for another purpose (in which case ASIC may be required to afford procedural fairness and hence defeat the purpose of the release of information).[39]

Legislative amendments proposed by ASIC

6.54 In its submission to the inquiry, ASIC provided the committee with a number of possible legislative amendments to provide more public transparency of information and facilitate greater information sharing between ASIC and the ATO to assist in identifying possible tax avoidance and aggressive minimisation.

6.55 The committee notes that ASIC has not proposed any changes to a director's duty to act in the best interests of shareholders.[40] ASIC considers that it would be

35 *Submission 32*, p. 3.

36 *Submission 32*, pp. 3–4.

37 *Submission 32*, p. 6.

38 *Submission 32*, pp. 6–7.

39 *Submission 32*, p. 7.

40 Section 181 of the Corporations Act.

impractical and inappropriate to attempt to address tax minimisation by modifying this general duty which is important to protect shareholder interests.[41]

Disclosure of related party information in financial reports

6.56 Currently, the accounting standards contain disclosure requirements for related party relationships and transactions. These disclosures could help the public identify non-arm's length arrangements that might be used to minimise tax payments in Australia. However, the requirements do not apply to non-reporting entities.

6.57 ASIC proposes that taxation legislation could be amended so that non-reporting entities would be required to make these disclosures in financial reports under the Corporations Act if the ATO requires them to do so.

Grandfathered large propriety companies

6.58 Currently, a 'grandfathered' large proprietary company is required to prepare a financial report but is exempt from lodging it with ASIC if it meets certain conditions.[42] This reporting exemption means that certain companies are not subject to the same level of public scrutiny as other similarly sized companies by virtue of having an exemption because of when reporting requirements were introduced. The lack of availability of public financial reports reduces transparency about possible indicators of tax avoidance or tax minimisation.

6.59 ASIC proposes that the concept of 'grandfathered large proprietary companies' could be removed from the Corporations Act and these companies required to lodge financial reports with ASIC. This would remove any inequity with similar companies that are required to lodge financial reports. Consideration may need to be given to privacy concerns that may have contributed to the original decision to provide the grandfathering exemption.

Confirmation whether a propriety company is small

6.60 Currently, most of the more than 1.7 million Australian proprietary companies are not required by the Corporations Act to lodge financial reports with ASIC. Some of these companies may become large but fail to prepare and lodge financial reports. There is no requirement for these companies to confirm with ASIC annually that they are small, which, if required, would act as a trigger for the companies and their directors to review the company's status.

6.61 ASIC proposes that proprietary companies could be required by the Corporations Act to confirm with ASIC whether they remain small. However, this would need to be balanced against the administrative cost and red tape imposed on the

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41 *Submission 32*, p. 21.

42 For more information about the conditions relating to grandfathered large propriety companies, see *Exemption from having to lodge a financial report for 'grandfathered' large proprietary company*, http://asic.gov.au/regulatory-resources/financial-reporting-and-audit/preparers-of-financial-reports/large-proprietary-companies-that-are-not-disclosing-entities/exemption-from-having-to-lodge-a-financial-report-for-grandfathered-large-proprietary-company/ (accessed 9 August 2015).

vast majority of proprietary companies that are small for any given year. There is also likely to be a cost to ASIC in following up companies that do not confirm their status for any given year.

Limitations on information sharing with the ATO

6.62 Currently, there are circumstances that sometimes require ASIC to provide procedural fairness to a person affected by the provision of information to the ATO that may help identify and address tax avoidance before the information is provided. This requirement has the potential to alert the person and defeats the purpose of the release of the information.

6.63 ASIC proposes that the confidentiality provisions in section 127 of the ASIC Act could be amended to put beyond doubt that ASIC is able to freely share information with the ATO without the need to provide procedural fairness to the affected person.

False identities of directors

6.64 Currently, ASIC has no authority to check the identity of individuals who are notified as being the directors of a company to be registered with ASIC. Such individuals could use false identities to form companies that are used in tax avoidance activities.

6.65 ASIC proposes that it could be allowed to require evidence of the identities of proposed directors of companies. The recommendation of the Financial System Inquiry to develop a national strategy for a federated-style model of trusted digital identities will assist with this.[43]

6.66 The committee notes that Treasury is undertaking a consultation process in relation to all of the recommendations proposed by the Financial System Inquiry which will inform the government's response.

Reporting relief for foreign groups operating through proprietary companies

6.67 According to ASIC, some proprietary companies controlled by foreign groups may be relying on Class Order 98/98 to not report in Australian, and may also be parts of groups that minimise tax on their business dealings with Australians. However, the underlying basis for the relief afforded by Class Order 98/98 is that the cost of preparing financial information significantly outweighs the benefit to the users of the financial report and imposes unreasonable burdens on the companies concerned.

6.68 As the ATO is a potential user of financial reports, it is well placed to assess where, for individual companies, the costs of preparing such reports do not significantly outweigh the benefits of public disclosure of matters such as effective tax rates or related party arrangements.

43 Recommendation 15, Financial System Inquiry, *Financial System Inquiry Final Report*, November 2014.

6.69 ASIC proposes that it could amend Class Order 98/98 so that relief is not available where the ATO notify that company (and ASIC) that the relief does not apply to that company.

Committee view

6.70 The committee welcomes the efforts of ASIC to put forward considered proposals that will assist in identifying corporate tax avoidance and aggressive minimisation. It considers that these legislative amendments should be considered with other measures to promote greater transparency of a corporation's activities and tax obligations, and enable better information sharing between agencies that hold information which could be used to identify and address corporate tax avoidance.

Recommendation 12

6.71 The committee recommends that taxation legislation be amended so that non-reporting entities are required to disclose related party information in financial reports under the Corporations Act if notified to do so by the ATO.

Recommendation 13

6.72 The committee recommends that the concept of 'grandfathered large proprietary companies' be removed from the Corporations Act, and these companies be required to lodge financial reports with the Australian Securities and Investments Commission (ASIC).

Recommendation 14

6.73 The committee recommends that all proprietary companies are required to review and confirm their size with ASIC annually.

Recommendation 15

6.74 The committee recommends that the confidentiality provisions in section 127 of the ASIC Act be amended to allow ASIC to share information with the ATO without having to notify the affected person.

Recommendation 16

6.75 The committee recommends that people who propose to become directors of companies be required to provide evidence of their identity to the ASIC.

Recommendation 17

6.76 The committee recommends that ASIC amend Class Order 98/98 so that a company is not eligible for financial reporting relief, where the ATO notifies the company and ASIC that the relief does not apply to that company.

Senator Sam Dastyari
Chair

Government Senators' Dissenting Report

1.1 Government Senators have deep concerns about some of the recommendations made in the interim report.

1.2 Most significantly, the interim report fails to recognise that the Coalition Government has taken strong action in our nearly two years in office to combat corporate tax avoidance.

1.3 The Government is committed to ensuring companies pay tax on profits properly attributable to profit generating activities undertaken in Australia. In preference to introducing new taxes on Australians, the Government simply wants to ensure individuals or companies that are avoiding tax pay their fair share. The Government is determined to achieve this without increasing the overall tax burden, or imposing additional complexity on those individuals and entities that do abide by our taxation rules.

1.4 In our role as G20 President during 2014, Australia took the lead in global efforts to address international profit-shifting arrangements. We led the global effort to crack down on tax avoidance by multinationals through the two-year OECD Base Erosion and Profit Shifting (BEPS) Project. This leadership will continue well into the future.

1.5 As part of the May 2015 Budget, the Government actioned the 2014 G20/OECD BEPS recommendations on Country-by-Country reporting, harmful tax practices, exchange of revenue authority rulings and treaty abuse rules. Additionally, the Government has commissioned the Board of Taxation to report back on implementing the G20/OECD BEPS anti-hybrid rules by May 2016.

1.6 The Government has also taken important steps domestically to strengthen Australia's defences against tax avoidance, including the tightening of our thin capitalisation rules to prevent multinationals claiming excessive debt deductions.

Multinational Anti-Avoidance Law

1.7 On Budget night, the Treasurer released the details of a new Multinational Anti-Avoidance Law, which will prevent multinationals using complex and artificial structures to escape paying Australian tax. The draft law was released for consultation on Budget night.

1.8 Multinationals who break the law and avoid paying their fair share will have to pay back the tax they owe (plus interest) and face penalties of up to 100 per cent of the tax owed.

1.9 As a result of Tax Office investigations the Government, including our agencies, have identified 30 large multinational companies that may have deliberately shifted profits away from Australia to avoid paying their fair share of tax in Australia.

1.10 The Bill to implement our Multinational Anti-Avoidance Law is scheduled for introduction into Parliament in the coming sitting weeks.

Country-by-Country reporting

1.11 On 6 August 2015, the Government released an exposure draft of legislation to implement the OECD's Country-by-Country reporting regime.

1.12 Country-by-Country reporting will require multinational companies to disclose the key details of their activities in each jurisdiction they do business. Tax authorities will have a global picture of how multinationals operate, including detailed information on the global allocation of revenues, profits, taxes paid and other economic activities.

1.13 Country-by-Country reporting was one of the key recommendations developed during Australia's G20 Presidency. Furthermore, Australia is one of the first countries to commit to implement the regime.

Voluntary disclosure code

1.14 The Government will work with business to develop a code for the public disclosure of information on taxes paid by large corporates.

1.15 The actions of a few businesses, particularly large multinationals engaging in aggressive tax avoidance, have tarnished the reputations of many businesses that are doing the right thing.

1.16 Some large businesses have responded by releasing detailed information about their tax affairs. This is pleasing—indeed many of the witnesses during Committee proceedings voluntarily released details of their tax affairs.

1.17 In the 2015–16 Budget, the Treasurer asked the Board of Taxation to lead the development of a new code on greater public disclosure of tax information by businesses, particularly large multinationals.

1.18 The Board of Taxation is conducting consultations on this measure in August and September 2015. Indeed this process is well underway and consultations are currently occurring.

Private company transparency

1.19 Under current legislation, the Commissioner of Taxation will shortly be required to publish the total income, taxable income and tax payable of companies with total income of $100 million or more each income year. This law was enacted by the former Labor Government.

1.20 However, this law contradicted repeated Labor commitments to protect confidential taxpayer information of private individuals.

1.21 The legislation also ignored the concerns of key stakeholders, went against international best practice and would potentially unfairly expose individuals to commercial and reputational damage.

1.22 For closely held Australian owned private companies, the publication of their tax affairs would effectively reveal details of the owner's finances, which would violate individual rights to privacy. The published information may also reveal commercially sensitive information which might harm the competitiveness of private businesses.

1.23 The law violates the important principle of taxpayer confidentiality. As former assistant treasurer Bill Shorten told the Parliament:

> The taxation law has long recognised that such protection is fundamental to ensuring that taxpayers maintain their confidence in the operation of the tax system. (Source: Bill Shorten, then Assistant Treasurer, Hansard, Wednesday, 29 September 2010)

1.24 Former Treasurer Wayne Swan also recognised the importance of confidentiality when he said:

> I would have thought that everyone out there that was concerned about good public administration would see the common sense in observing what the Tax Office says about confidentiality provisions because they are important to every Australian and it's not a decision of the Government, it's the decision of the Tax Office. (Source: Wayne Swan, doorstop interview: Brisbane: 24 January 2013)

1.25 The law would require publication of information already in the possession of the ATO.

1.26 Its release to a wider audience will not in any way enhance the ability of Australian tax authorities to collect additional revenue.

1.27 The release of this information will neither better protect the public nor enhance the quality of debate around tax avoidance.

1.28 The public will not be assisted in understanding the legitimacy of deductions or costs incurred by a company in calculating its reported income for a given income year, nor will the large number of state taxes an entity may pay (such as payroll and land tax) be considered.

1.29 It is the view of Government Senators that a voluntary disclosure code will strike a better balance between the need for transparency and the privacy and competitiveness concerns of business.

ATO resourcing

1.30 The ATO has been granted more resources than ever specifically dedicated to dealing with multinational tax avoidance.

1.31 The Public Groups and International division of the ATO has more specialised staff with greater access to resources than existed under the former Labor Government.

1.32 The ATO's multinational tax avoidance practice is also backed by significant private sector expertise and resources to ensure the effective sharing of industry knowledge.

Marketing hubs

1.33 The Government has ensured continued funding for the highly successful work undertaken by the ATO International Structuring and Profit Shifting (ISAPS) project, committing $87.6 million over the next three years. Under the programme, the ATO is reviewing the affairs of companies that have undertaken an international restructure or have significant levels of related party cross-border arrangements (including offshore marketing hubs).

1.34 The ATO's exchange of information with other tax administrations supports its local information gathering efforts. The ATO has worked particularly hard to develop strong relationships with revenue authorities in important jurisdictions for tax structuring, such as the Inland Revenue Authority of Singapore.

1.35 Additionally, a new focus on negotiating tax treaties with enhanced integrity measures, such as the recent Australia-Switzerland double taxation agreement, will allow for better information exchange between tax authorities.

Senator Sean Edwards
Deputy Chair

Senator Matthew Canavan
Senator for Queensland

Additional Comments from the Australian Greens

1.1 These additional comments wish to acknowledge the hard work and contribution of former Senator, Christine Milne, who referred the inquiry to this committee. With her Committee colleagues, the former Senator drove much of the work and direction of the committee. She has also contributed to these additional comments. Her informed and thorough questioning made many of the witnesses uncomfortably shift in their seats and extracted important information from them. Her contribution to this inquiry, like her contribution to public debate generally, has been invaluable.

1.2 The Australian Greens fully support the Chair's report. These additional comments offer a strong basis for further recommendations to be included and considered by the parliament and government.

1.3 These interim report recommendations are limited to measures focussing on public disclosure, transparency and financial reporting of multinational groups operating in Australia. The more substantive recommendations that focus on the mechanisms of base erosion and profit shifting will be dealt with in the final report.

1.4 Opening up financial details to public scrutiny is a strategic priority. Within international agreements to develop a uniform approach to tax avoidance, strong transparency changes are unilateral measures Australia can make straight away without disrupting the multilateral discussions, while also showing Australia is serious about confronting this global blight on national governments.

1.5 A strong suite of financial disclosure measures will be far more effective and less costly to the government than their proposed general anti avoidance measures which are notoriously difficult to prosecute in litigation.

1.6 Public dissemination of a company's financial accounts carries with it a severe reputational risk to globally significant firms. Public exposure of tax arrangements in the UK has seen companies like Starbucks and Amazon announce that they will commence paying tax on UK sales after sustained public outcry.[1] Similarly, during this inquiry, Glencore announced it will close its marketing hubs so that transactions occur and are taxed in Australia – however this was also influenced by prevailing commercial arrangements.[2]

1.7 Just as efficient markets require the removal of information asymmetry for good investment decisions, efficient protection of the public interest and public revenue requires the removal of information asymmetry between corporate actors and the public, represented through our public institutions and agencies.

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1 'Starbucks pays UK corporation tax for the first time since 2009', *BBC News*, 23 June 2013; Simon Bowers, 'Amazon to begin paying taxes on UK retail sales', *The Guardian*, 23 May 2015.

2 Ben Butler, 'Glencore to close down Singapore Trading Hub', *The Australian*, 10 April 2015.

1.8 As noted in the main report, prior to this inquiry, the public service, the Senate and the public generally, have largely been kept ignorant about the depth and breadth of aggressive tax minimisation by globally linked companies operating in Australia. The significant public interest in this inquiry can be largely attributed to the paucity of publicly available information about the tax arrangements of high-profile companies operating in Australia.

1.9 This inquiry has to date, helped unravel some of the activities and structures of aggressive tax minimisation, however there is still much more uncovering to be done. Opening up the books of companies is an indispensable structural change that needs to occur in order to facilitate public awareness and create new commercial practices.

1.10 Investigative financial journalism has an important role to play as the medium to translate this information to the public. To date, this has been very successfully done by the hard work of journalists such as Michael West, Neil Chenoweth and Nassim Khadem. This important public function of media is however compromised through the revelation during the inquiry that the ATO's most 'at risk' company for tax evasion is News Corporation.[3]

1.11 When a company with a significant market share of media reach is implicated in tax minimisation practices, it raises the legitimate question of whether the resources to investigate and expose such practices will be made available by the media company. Tax avoidance not only affects our revenue base, but has the potential - if left unguarded - to threaten the way our polity operates.

1.12 The secrecy of financial transactions and accounts is permitted through the minimal to non-existent requirements of filing detailed financial statements with ASIC. The Greens are strongly of the view that companies operating in Australia which are connected to a larger group of international companies should not be eligible for 'grandfathered treatment', exemption from reporting or special purpose accounting. The risk these companies pose to the government's consolidated fund require full compliance with general purpose financial reporting. The Australian Taxation Office (ATO) and accountants acting in the public interest are then able to scrutinise those statements.

1.13 Financial statements should be completed in accordance with prevailing accounting standards. Special purpose accounting should not be available as a rule to globally structured companies.

1.14 While the Committee has agreed to investigate this further in the final report, the Australian Greens wish to note in this interim report, the crucial importance of such a measure to allow greater forensic examination of a company's activities.

1.15 While disclosure of financial material can assist Australians to be informed about the activities of globally-linked firms, it must be assisted with public disclosure of past and concurrent practices. 10 Australian companies shifted $31.4 billion out of

3 Neil Chenoweth, 'Rupert Murdoch's News Corp is ATO's top-tax risk', *Australian Financial Review*, 11 May 2015.

Australia to Singapore in the 2011-12 financial year alone. At the top of the list was a single energy company that shifted $11 billion.[4] Under current law and practices, these companies have a right to be kept confidential. Confidentiality of these significant transactions erodes the public interest.

1.16 Such a significant transfer of Australian-created wealth requires the shifting of proof to those who have all the information about their commercial activities. These companies should be required to explain to the Australian public – and not just the Australian Taxation Office – why these transactions are legitimate.

1.17 To ensure the integrity of our political discourse and strengthen our revenue base, in addition to those recommendations in the Chairs report, the following reporting measures should be immediately implemented.

Recommendation 1

1.18 The Australian Taxation Office should be required to publish the details of the top 10 Australian companies that transfer wealth off shore in each financial year. A right of reply will be afforded to each named company to justify its transactions.

Recommendation 2

1.19 Australian companies that are part of a larger group of international companies should not be eligible for special purpose accounting treatment and must provide ASIC with detailed financial reports to prevailing accounting standards.

Recommendation 3

1.20 Australian companies that are part of a larger group of international companies should include in their financial statements the value and purposes of all transactions between related companies.

Recommendation 4

1.21 ASIC should publish all details of exemptions from general purpose accounting by firm and association to global related parties, with a justification from ASIC as to why the exemption is necessary. ASIC should also publish any exemption from reporting timelines and clearly outline any changes to class orders that are implemented.

1.22 In seeking these gains in transparency of tax payments, it is also important to build on the gains already enshrined in law. Recommendation 4 informs the Senate to maintain existing transparency laws which apply to both public and private companies.

1.23 The current law requires a private or public company with income over $100 million a year to provide to the ATO for publication, the name and Australian

4 Heath Aston, 'Energy Company's $11 billion transfer to Singapore rings tax avoidance alarm bells', *Sydney Morning Herald*, 4 April 2015.

Business Number, the total income, the taxable income or net income (if any), and income tax payable.

1.24 The government has stated its intention to remove the requirement for private companies to comply with this public disclosure on the basis that individuals would be subject to kidnap fears.

1.25 The Committee sought information from Treasury and the Australian Taxation office as to whether they had provided advice on this risk by their own volition or whether the AFP had requested their advice. No evidence was provided that the threats of kidnap were based on information provided by any government agency. In the absence of such evidence, the government's sole justification for this exemption is simply not supported by facts.

1.26 While there was no evidence in support of carving out new exemptions, there was information provided to the committee that such an exemption may in fact assist further tax minimisation. The Uniting Church of Australia, Synod of Victoria and Tasmania supplementary submission states:

> …a document obtained from the Australian Taxation Office (ATO) under freedom of information has revealed that the private companies linked to Australian high wealth individuals have average profit margins lower than the other categories of companies (foreign owned and Australian publicly listed) in the group that the legislation applies to. Almost half of these companies are foreign-headquartered and two-thirds have some form of international related party dealings.
>
> They account for most of all international related party dealings reported to the ATO, despite being only 21% of the businesses caught under the tax transparency measures of the Tax Laws Amendment (2013 Measures No. 2) Act. It is possible that the lower average profit is simply due to this category of companies performing worse on average than other categories of businesses. However, there is the possibility that the lower average reported profitability is due to aggressive tax practices.

1.27 Their analysis shows a pattern of globally connected private companies with lower-than average profits. These are hallmarks of tax-avoidance structures and if the government persists with this exemption, they may be responsible for exacerbating rather than restricting aggressive tax minimisation practices.

Recommendation 5

1.28 In the absence of a compelling public policy purpose, the government should abandon legislative changes exempting private companies from providing minimal details about their profitability and taxes.

1.29 The prolific creation of trusts and subsidiary companies to facilitate the transfer of goods, services and income flows makes the comprehensive tracking of commercial activity and ultimate beneficial ownership impossible.

1.30 Not only does such secrecy enable tax avoidance, but it also has the potential to facilitate illicit flows of money that could be utilised by international organisations to finance criminal activities.

Recommendation 6

1.31 That the Parliament establish a public register of beneficial ownership of companies and trusts so that identification of financial beneficiaries can be traced and publicly identified. The Australian government should also work closely with other countries to establish a global standard for such registers.

1.32 While the Australian Greens support recommendation 7 in the Chair's report, we believe there is too much scope for the government to not act on the need for country-by-country reporting.

1.33 Before the Senate is the Corporations Amendment (Publish What You Pay) Bill 2014 to establish mandatory reporting requirements of payments made by Australian based extractive companies to foreign governments. The bill requires that companies must disclose these payments on a country-by-country and project-by-project basis.

1.34 It would apply to all Australian companies involved in extractive industries, including oil, gas, mining and native forest logging. It will apply to both Australian public and large proprietary companies. The overall aim of the Bill is to improve transparency and accountability of Australian extractive companies. The Bill aims to deter corruption by requiring payments to be made public.

1.35 Under the legislation, these companies and their subsidiaries would be required to submit a financial report detailing all payments made to government entities overseas over $100,000. This threshold would bring Australia in line with the standards set by the US, EU and UK in their legislation and directives.

1.36 The legislation sets out that these reports must be in an open and machine-readable format, and would be published by ASIC, to ensure public accessibility and accountability. Misleading reporting will be dealt with under the rules that currently exist relating to financial statements.

1.37 This legislation intends to align Australia's legislative response to extractive industry transparency with that that is being pursued around the world, including in the United States, the United Kingdom and Canada.

Recommendation 7

1.38 That the Senate pass the Corporations Amendment (Publish What You Pay) Bill 2014.

Senator Richard Di Natale
Leader of the Australian Greens

Appendix 1

Submissions and additional information received

Submission Number	Submitter
1	Mr Eric Bruner
2	Mr Mark Lyons • Supplementary submission 2.1
3	Taxpayers Australia Limited
4	Aurizon
5	Queensland Nurses' Union
6	Toll Group
7	BWP Trust
8	Fortescue Metals Group Limited
9	Mr David Myer
10	ANZ
11	Stockland
12	Mr Berrick Boyd
13	Ms Eileen Ross
14	Community and Public Sector Union
15	Deloitte Touche Tohmatsu
16	Mirvac
17	Origin Energy Limited
18	Property Council of Australia
19	Ms Betty Lee McGeever
20	Mr Alan McGrath
21	Mr Alan Wilson
22	Associate Professor Antony Ting
23	Mr Ian Gillard
24	Emeritus Professor Marcus Wigan
25	Scentre Group
26	Sydney Airport
27	OZ Minerals Limited
28	Rio Tinto

29 DEXUS Property Group
30 Publish What You Pay Australia
31 Insurance Australia Group Limited
32 Australian Securities and Investments Commission
33 The Tax Institute
34 Computershare Limited
35 Woodside Energy Ltd
- Supplementary submission 35.1

36 Asciano Limited
37 ResMed Ltd
38 Echo Entertainment Group Limited
39 PricewaterhouseCoopers
40 Cromwell Property Group
41 The GPT Group
42 Institute of Public Affairs
43 Challenger Limited
44 AMP Limited
45 Spark Infrastructure
46 James Hardie Industries
47 Orica Limited
48 Australian Taxation Office
49 Mr Kendall Lovett
50 Mr Rob Cannon
51 News Corp Australia
52 Glencore
53 Ernst & Young
54 Minerals Council of Australia
55 Transurban
56 Mr Martin Lock
57 Google Australia
58 Newcrest Mining Limited
59 Corporate Tax Association
60 GetUp

61 Name Withheld

- Attachment 1
- Attachment 2

62 The Australia Institute

63 Lend Lease

64 Professor Miranda Stewart, Tax and Transfer Policy Institute, Australian National University

65 Mr Rob Wallace

66 Apple

67 ActionAid Australia

68 Brambles Ltd

69 Mr Andrew Noble

- Attachment 1

70 Macquarie Group

71 Financial Services Council

72 Lee & Associates

73 CPA Australia

74 Uniting Church in Australia, Synod of Victoria and Tasmania

- Supplementary submission 74.1
- Attachment 1
- Attachment 2
- Attachment 3

75 Dr Roman Lanis and Mr Ross McClure, University of Technology, Sydney

76 Dr John Miller AO

77 Microsoft

78 United Voice

- Supplementary submission 77.1

79 Tabcorp Holdings Limited

80 Name Withheld

- Supplementary submission 80.1

81 BHP Billiton

82 Confidential

83 Name Withheld

84 Confidential

85 Centre for Tax Policy and Administration, OECD

86 BWP Trust

87 Business Council of Australia

88 AGL Energy Limited

89 IBM Australia & New Zealand

90 Chartered Accountants Australia and New Zealand

91 KPMG

92 Infrastructure Partnerships Australia

93 Professor Kerrie Sadiq, QUT Business School

94 Macquarie Telecom

95 Mr David Allen

96 Name Withheld

97 Mr Charles Lowe

98 Squiz

99 Mr Pranay Bhattacharya

100 Confidential

101 Accommodation Association of Australia

102 Eli Lilly Australia

103 Medicines Australia

- Supplementary submission 103.1

104 MSD

105 Johnson & Johnson Pty Ltd

106 Roche Products Pty Limited

107 GSK Australia

- Supplementary submission 107.1

108 Novartis Australia

109 Sanofi

110 Pfizer Australia

111 AstraZeneca Australia

112 ALDI Australia

113 Costco Wholesale Australia

114 Santos Ltd

115 BP Australia Pty Ltd

116 ExxonMobil Australia Group of Companies

117	Viva Energy Australia Ltd
118	Caltex Australia
119	Shell Australia
120	Origin Energy Limited
121	Chevron Australia

Tabled documents

1. Document tabled by Professor Richard Vann at a public hearing held in Sydney on 8 April 2015.

2. Documents tabled by Glencore at a public hearing held in Melbourne on 10 April 2015.

3. Document tabled by Rio Tinto at a public hearing held in Melbourne on 10 April 2015.

Additional information received

1. Document provided by Professor Richard Vann following the public hearing held in Sydney on 8 April 2015.

2. Documents provided by News Corp Australia following the public hearing held in Sydney on 8 April 2015.

3. Document provided by Deloitte Touche Tohmatsu following the public hearing held in Melbourne on 10 April 2015.

4. Document provided by Rio Tinto on 28 April 2015.

5. Document provided by the Australian Taxation Office on 1 May 2015.

Answers to questions on notice

1. Answers to questions on notice from a public hearing held in Sydney on 8 April 2015, received from Professor Antony Ting on 23 April 2015.

2. Answers to questions on notice from a public hearing held in Canberra on 9 April 2015, received from KPMG on 23 April 2015.

3. Answers to questions on notice from a public hearing held in Melbourne on 10 April 2015, received from Mr Martin Lock on 23 April 2015.

4. Answers to questions on notice from a public hearing held in Sydney on 8 April 2015, received from the Property Council of Australia on 23 April 2015.

5. Answers to questions on notice from a public hearing held in Melbourne on 10 April 2015, received from PricewaterhouseCoopers on 24 April 2015.

6. Answers to questions on notice from a public hearing held in Canberra on 9 April 2015, received from EY on 24 April 2015.

7. Answers to questions on notice from a public hearing held in Sydney on 8 April 2015, received from the Australian Taxation Office on 24 April 2015.

8. Answers to questions on notice from a public hearing held in Canberra on 9 April 2015, received from the CPSU on 24 April 2015.

9. Answers to questions on notice from a public hearing held in Sydney on 8 April 2015, received from Microsoft on 24 April 2015.

10. Answers to questions on notice from a public hearing held in Melbourne on 10 April 2015, received from Deloitte on 24 April 2015.

11. Answers to questions on notice from a public hearing held in Sydney on 8 April 2015, received from Google Australia on 24 April 2015.

12. Answers to questions on notice from a public hearing held in Canberra on 9 April 2015, received from the Business Council of Australia on 24 April 2015.

13. Answers to questions on notice from a public hearing held in Melbourne on 10 April 2015, received from Glencore on 24 April 2015.

14. Answers to questions on notice from a public hearing held in Melbourne on 10 April 2015, received from BHP Billiton on 24 April 2015.

15. Answers to questions on notice from a public hearing held in Canberra on 9 April 2015, received from the Australian Securities and Investments Commission on 27 April 2015.

16. Answers to questions on notice from a public hearing held in Melbourne on 10 April 2015, received from Rio Tinto on 27 April 2015.

17. Answers to questions on notice from a public hearing held in Sydney on 8 April 2015, received from Apple Pty Limited on 28 April 2015.

18. Answers to questions on notice from a public hearing held in Sydney on 22 April 2015, received from the Australian Taxation Office on 1 May 2015.

19. Answers to additional questions on notice, received from PricewaterhouseCoopers on 7 May 2015.

20. Answers to additional questions on notice, received from KPMG on 8 May 2015.

21. Answers to additional questions on notice, received from EY on 8 May 2015.

22. Answers to additional questions on notice, received from Google Australia on 8 May 2015.

23. Answers to additional questions on notice, received from Deloitte on 8 May 2015.

24. Answers to additional questions on notice, received from the Australian Taxation Office on 8 May 2015.

25. Answers to additional questions on notice, received from Fortescue Metals Group Limited on 8 May 2015.

26. Answers to additional questions on notice, received from Glencore on 12 May 2015.

27. Answers to additional questions on notice, received from Apple Pty Limited on 13 May 2015.

28. Answers to additional questions on notice, received from BHP Billiton on 15 May 2015.

29. Answers to additional questions on notice, received from News Corp Australia and dated 15 May 2015.

30. Answers to additional questions on notice, received from Rio Tinto on 21 May 2015.

31. Answers to additional questions on notice, received from Apple Pty Limited on 22 May 2015.

32. Answers to additional questions on notice, received from Microsoft on 22 May 2015.

33. Answers to additional questions on notice, received from Google Australia on 25 May 2015.

34. Answers to additional questions on notice, received from BHP Billiton on 25 May 2015.

35. Answers to questions on notice from a public hearing held in Sydney on 1 July 2015, received from the Australian Taxation Office on 14 July 2015.

Appendix 2

Public hearings and witnesses

SYDNEY, 8 APRIL 2015

CARLSON, Mr Anthony, Member, New South Wales Branch, United Voice

CARNEGIE, Ms Maile, Managing Director, Google Australia

CLARKE, Mr Julian, Chief Executive Officer, News Corp Australia

CRANSTON, Mr Michael, Acting Second Commissioner, Compliance Group, Australian Taxation Office

DOYLE, Ms Kay, Member, New South Wales Branch, United Voice

HASTINGS, Ms Debbie, First Assistant Commissioner, Review and Dispute Resolution, Australian Taxation Office

HIRSCHHORN, Mr Jeremy, Deputy Commissioner, Public Groups, Australian Taxation Office

JORDAN, Mr Chris, Commissioner of Taxation, Australian Taxation Office

KING, Mr Tony, Managing Director, Australia and New Zealand, Apple Pty Ltd

KONZA, Mr Mark, Deputy Commissioner, International, Australian Taxation Office

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Appendix 3

A consistent and useful effective tax rate methodology to assess the global tax performance of multinationals in relation to Australian-linked business operations[1]

The purpose of this paper is to propose a metric for the global tax performance of multinationals in relation to their Australian-linked business operations.

The formula is intended to identify an economic group's total worldwide profit from Australian linked business activities, and the Australian and offshore tax paid on that profit. This will provide an indication of total tax borne as well as the proportion of those profits actually taxed in Australia.

Our development of this formula is continuing, but it is considered that the formula is at a stage of development that means it can provide useful information on effective tax borne on a "like for like" basis.

Note that we have not yet had the opportunity to consult with taxpayers or other stakeholders during the development of this methodology. In the ordinary course of events this is something we would certainly seek to do, however, given the time constraints, this has not been possible to date.

It should also be recognised that views differ as to the appropriate formula to use to calculate effective tax rates and that the response to this methodology is likely to be no different. There is merit, particularly in the context of the debate on multinational tax, in having a standardised approach to effective tax borne to facilitate like for like comparisons (both domestically and internationally). This formula is an option for how that standardised approach might look and is intended to encourage broader discussion about the need for, and appropriateness of, a standardised approach to calculating effective tax borne.

The metric

Denominator

The denominator is the total economic group profit from business activities which are linked to Australia. There is a variant which excludes some abnormal items from the profit calculation.

The starting point is the consolidated accounting profit of the Australian group (which may include offshore subsidiaries). To develop the estimate of the total economic group profit from business activities linked to Australia, it is necessary to make a

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1 This effective tax borne formula was provided to the committee by the Australian Taxation Office in an answer to a question on notice following the public hearing on 22 August. See Australian Taxation Office, *Answer to Question on Notice No. 18*.

range of adjustments to that profit (especially for inbound multinationals, where the Australian accounts will only be a subset of the economic group's activity).

Numerator

There are two alternative numerators under the combined metric:

- the Australian tax (including non-resident withholding taxes) paid on those business activities by the economic group;
- the global tax paid on those business activities by the economic group.

General comments

This metric deliberately includes profits of the economic group which may not be taxable in Australia under Australia's source, residency and anti-profit shifting rules or the OECD/Double Tax Agreement principles intended to avoid double taxation. The metric seeks to reflect all of the channel profit derived from business activities involving Australia and the Australian and global tax paid on that channel profit.

Alternative methodologies, which are simply based on consolidated Australian accounting profit without adjustment (especially for inbound multinationals), beg the question around appropriate pricing of international related party dealings and whether they are at arm's length. By including the entire economic group's profit from Australian linked activities, international related party dealings are effectively ignored.

Under the metric, where some of an economic group's activities are undertaken in low tax jurisdictions, the average global tax rate may legitimately be below (or significantly below) the Australian corporate tax rate. By including a metric which incorporates global tax, it will demonstrate a weighted average global tax rate on those business activities. In reporting this metric, a taxpayer may wish to provide an explanation of the proportion of profits taxable in relevant jurisdictions.

The amount of Australian tax paid will reflect the impacts of tax policy settings (ie the legislative rules that define the Australian tax base, any tax expenditures taken into account in the tax reconciliation process and tax credits and offsets that may be available) as well as the impacts of any base erosion and profit shifting activities.

The methodology seeks to align the Australian accounting consolidated group with the Australian tax consolidated groupings and aggregation of Australian tax payments may be needed in some cases where there is more than one tax consolidated group in the economic group.

The analysis is designed to apply equally to Australian headquartered entities that are purely domestic (domestic entities), Australian headquartered entities that also have offshore investments (outbound MNEs), and foreign headquartered entities that have investments in Australia and may also be using Australia as a regional headquarters (inbound MNEs).

The elements raised in this paper are indicative and are unlikely to be exhaustive. In applying the metric to a particular taxpayer:

- The general principles of the paper should be applied as far as possible where there are scenarios not contemplated in the paper;
- If the methodology is considered to provide a misleading outcome in the particular circumstances, this should be disclosed;
- Where it is not possible to obtain precise information in relation to particular adjustments, a "best estimate" approach should be adopted within materiality principles.

Comments in relation to profit of the economic group

The methodology starts with the accounting profit of the Australian economic group. This will include offshore subsidiaries of the Australian economic group, but will not include offshore parent entities or sister entities.

A series of adjustments are required to be made to:

- Include economic group profit from business activities which have an Australian element but are not included in the consolidated accounts of the Australian accounting group (relevant primarily to inbound MNEs);
- (Potentially) exclude economic group profit (and the related tax) from operating businesses in offshore subsidiaries which have no Australian connection (relevant primarily to outbound MNEs).

Where transactions with offshore entities are already within the consolidated Australian accounting group, no adjustment is required as the third party income and expenses are already reflected in the consolidated Australian accounting group and the effects of related party dealings (both onshore and cross-border) are washed out in the course of the accounting consolidation process.

The specific adjustments are discussed below.

Income earned from Australian residents by offshore companies not within the Australian accounting consolidated group

The economic group may earn income from Australian residents outside the Australian accounting consolidated group.

This revenue should be included in determining the profit to the economic group attributable to the Australian business operations.

Third party costs incurred in deriving that revenue should similarly be included (which could include purchases from third party suppliers, depreciation on plant and equipment etc).

Purchases and other services from offshore related parties

Where the Australian accounting group purchases goods and services from offshore related parties, the offshore entity will usually make a profit (offshore) as part of that supply chain.

Under the metric, the entire supply chain profit is a profit of the economic group arising from Australian business activities.

As such, the profit of other group companies from these sales should be included in the metric.

This means that accounting profit should be adjusted to exclude payments for goods, services and intellectual property from related parties, but should then be adjusted to include third party expenses in manufacturing / purchasing the goods, providing the services and/or developing the intellectual property. This could include depreciation / amortisation of plant or capitalised intellectual property costs.

This would include profit made offshore on agency sales by related selling agents.

Sales to offshore related parties (including trading hubs)

Where the Australian accounting group sells goods or services to offshore related parties, the offshore entity will usually make a profit as part of that supply chain.

Where that profit is not already included in the Australian accounting profit, the economic group profit should be adjusted accordingly.

This could be implemented by adding the profit of the offshore entity or by excluding the sales revenue earned from the related party, and replacing with the revenue from its on-sales to third parties, less its other third party expenses (including employee costs).

Excessive debt allocations to Australian entities

The Australian group will have third party debt attributable to its operations (and the related interest expense in its financial accounts).

It may also have related party debt from its offshore parent / sister companies (occasionally but rarely from offshore subsidiaries).

For the purposes of this methodology, it is assumed that interest on third party debt is a legitimate business expense of the Australian operations (noting that in some cases that debt may actually be extended on the security of offshore subsidiaries).

Related party debt may reflect:

- A specific on-lending of third party debt raised offshore;
- A general on-lending of third party debt (resulting in the Australian operations having the same level of third party indebtedness as the entire group); or
- An incremental gearing level in Australia over the group's level.

In relation to the first two categories, any margin earned by the related party on the onlending is a profit to the economic group attributable to the Australian business operations.

In relation to the third category, the incremental interest income of the related party is a profit to the economic group attributable to the Australian business operations.

Similar principles apply in relation to other financing elements such as related party derivatives and foreign exchange gains and losses.

Equity accounted subsidiaries

There are complexities relating to equity accounted subsidiaries (ie subsidiaries where there is a significant holding, but not enough to tax consolidate).

There are three proposed approaches:

- to include the relevant percentage of their profits in the economic group profit (and following on from this, the relevant percentage of their tax); or
- to exclude the profit attributable to equity accounted subsidiaries, but to then include dividends from the subsidiaries in economic group profit (potentially 'grossing up' for underlying tax borne at the subsidiary level).
- to exclude the profit attributable to equity accounted subsidiaries entirely.

Any of these approaches should be acceptable.

Abnormal items

Accounting profit in a particular year may be artificially suppressed (or inflated) through impairments or revaluations of intangible or other long term asset holdings (such as property).

These amounts should be excluded to provide a normalised accounting profit.

Other extraordinary items should also be excluded where appropriate.

Comments in relation to tax paid

Use of tax paid rather than income tax expense

The proposed metric is based on tax actually paid in relation to a period rather than income tax expense according to accounting concepts.

In this regard, income tax expense for accounting purposes may include amounts which are not likely to be paid / received in the short to medium term ("deferred tax expense"). It may also include amounts such as "risk provisions" for potential tax disputes. On the other side, it may be artificially low through the generation of carry forward losses in part of a group, which cannot be offset against gains from another part of the group.

Some taxpayers may wish to provide a reconciliation of total income tax expense to tax paid (primarily the amounts which make up deferred tax expense, although there may be some current tax expense items). Many of these items will be impacts of deliberate tax policy settings (for example accelerated depreciation).

This could include elements such as:

- Tax losses recouped
- Accelerated depreciation for tax purposes (including immediate write-offs of items such as exploration expenditure)
- Deferred tax liabilities for "top up" tax under offshore CFC regimes

Exclusion of royalties and excise

It is not proposed to include royalties and excise in the metric as these are not generally considered to be income taxes and apply to some but not all industries.

However, it is important to note that these taxes do contribute to the total contribution to Government of an economic group.

Withholding taxes

Where an amount of income is included in economic group profit (eg through adjusting to include interest income received by offshore companies from Australian entities), the relating Australian withholding tax should be included in Australian tax paid.

Offshore tax

Where a profit or margin earned by an offshore entity is included in economic group profit, that tax should be included in the global tax paid.

This will include tax paid on those profits in third countries under controlled foreign company rules and/or on repatriation of those profits.

Equity accounted subsidiaries

Depending on the methodology adopted for equity accounted subsidiaries, different approaches need to be taken in relation to underlying tax.

- Under the first methodology, the relevant proportion of underlying tax paid should be included;
- Under the second methodology, an amount should be included based on the average underlying tax rate applicable to the equity accounted subsidiary (effectively 'grossing up' the after tax profits distributed to a pre-tax amount);
- Under the third methodology, no amount should be included.

Disputed amounts of tax

Where there are significant disputes in relation to tax payable (for example, taxpayer objections or litigation in relation to returns lodged, or requests for amendment not yet processed), these should be separately disclosed and an adjusted metric separately provided.

Where there is an amended assessment and there has been an arrangement to pay half the tax in dispute, different approaches can be taken:

- Include the arrangement amount with no further disclosure;
- Include disclosures around best/worst case scenarios (i.e. reflecting the positions where either party is successful in litigation); or
- A probability approach based on litigation risk.

Methodology

Comprehensive normalised profit

Consolidated accounting profit of Australian entities / branches (including offshore subsidiaries)

Adjustments for income earned from Australian residents by offshore companies not within the accounting consolidated group

- Add sales to Australian residents not included in Australian group accounting profit

- Include third party costs incurred overseas in deriving those sales (eg purchases from third party suppliers) not already included in Australian accounts.

Adjustments for purchases and other services from offshore related entities

- Exclude cost of goods sold on items purchased from related companies (which are not in the Australian accounting group)

- Include third party costs in manufacturing / purchasing those goods*

- Exclude cost of other property purchased from related companies (which are not in the Australian accounting group), eg, debts sold in a factoring business

- Include third party costs in manufacturing/acquiring that property*

- Exclude expenses for services from related companies (which are not in the Australian accounting group), including management and administrative services

- Add profit made offshore on agency sales by related selling agents (which are not in the Australian accounting consolidated group)

- Include worldwide third party costs of those services not already included in Australian accounts*

- Exclude royalty expenses for intellectual property obtained from related companies (which are not in the Australian accounting consolidated group)

- Include third party expenses incurred in developing such intellectual property not already included in Australian accounts*

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* Third party expenses or costs which relate to both the Australian operations and to non-Australian operations should be allocated in accordance with the segment accounting principles in paragraphs 25 to 27 of AASB 8.

Adjustments for sales to offshore related entities

- Add profit made offshore in trading hubs (which are not in the Australian accounting consolidated group)

- Add profit made offshore in other subsidiaries from the on-sale of goods and services acquired from Australian entities (net of amounts already included in Australian accounting group by way of sales or other revenue)

Adjustments for excessive debt allocations to Australian entities

- Exclude interest expense on loans from related companies (which are not in the Australian accounting consolidated group)

- Include interest expense on third party loans where those loans are specifically on-lent to the Australian group

- If Australian group has third party borrowings (and specifically on-loaned amounts) less than worldwide level, include estimated share of worldwide third party interest expense required to bring Australian group to average level of third party borrowing (average debt load at average rate)

- Exclude income and expenses for derivatives with related companies (which are not in the Australian accounting consolidated group) (to the extent the economic group has not entered into back to back derivatives with third parties)

- Exclude foreign currency gains or losses on loans or derivatives from related companies (which are not in the Australian accounting consolidated group) (to the extent the economic group has not entered into back to back transactions with third parties)

- Include any third party costs of foreign currency hedging for Australian dollar exposure for Australian dollar funds provided to Australian group if not already included in Australian accounts*

Adjustments for equity accounted subsidiaries

Depending on methodology adopted:

- Adjust to include relevant percentage of profits

- Exclude all profits attributable to the equity accounted subsidiaries; and/or

- Include dividends received from equity accounted subsidiaries (potentially 'grossed up' for tax)

- Subtract profit attributable to equity accounted minority holdings in subsidiaries

Comprehensive profit (A)

- Exclude revaluations / impairments on intangibles

- Exclude other extraordinary items where appropriate

Comprehensive normalised profit (B)

Effective tax paid

Australian corporate tax actually paid in relation to the period

- Add: Australian interest withholding tax paid on related company borrowings (to extent interest income included in adjusted group profit)

- Add: Australian royalty withholding tax paid on related company royalties (to extent royalty income included in adjusted group profit)

- Add: Australian dividend withholding tax paid on dividends remitted (to extent dividend income included in adjusted group profit)

- Add: (assuming relevant approach taken to equity accounted subsidiaries) proportionate share of Australian corporate tax actually paid by non-100% subsidiaries where profit included in Australian consolidated accounting group

- Add/Subtract: amended assessments / objections / requests for refunds of tax not yet processed

Total effective Australian tax paid (C)

- Foreign tax paid on business operations included in accounting group consolidated profit

- Foreign tax paid on related party interest income (to extent included in adjusted group profit)

- Foreign tax paid on related party royalty income (to extent included in adjusted group profit)

- Foreign tax paid on dividends received from Australian group (to extent included in adjusted group profit)

- Foreign tax paid on profit on goods sold to Australian group (to extent included in adjusted group profit)

- Foreign tax paid on related party services income (to extent included in adjusted group profit)

Total effective foreign tax paid (D)

Total effective global tax paid (E)=(C + D)

Metrics to assess the global tax performance of multinationals in relation to Australian linked business operations

Australian tax performance on Australian linked business operations

Australian effective tax paid ratio: C/A

Australian normalised effective tax paid ratio: C/B

Global tax performance on Australian linked business operations

Global effective tax paid ratio: E/A

Global normalised effective tax paid ratio: E/B