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Senate Economics Reference Committee
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Our ref 41014592_1

26 March 2015

By email

Dear Dr Dermody

Senate Economics References Committee inquiry into corporate tax avoidance and aggressive minimisation

Thank you for the opportunity to make a submission to the inquiry by the Senate Economics References Committee (the Committee) as to whether there is 'tax avoidance and aggressive minimisation by corporations registered in Australia and multinational corporations operating in Australia'.

KPMG is a global network of independent professional services firms located in 155 countries, collectively employing over 162,000 people. In Australia, KPMG has over 5,000 people (including approximately 400 partners) who provide audit, tax and advisory services to clients. KPMG's Tax team in Australia is made up of over 750 people; including 98 tax partners.

Our submission, attached as Appendix 1, addresses specific items of the inquiry's terms of reference. In summary, we make the following observations:

- *Australia has a robust and comprehensive corporate tax system administered by a capable regulator.*

The robustness and comprehensiveness of the Australian corporate tax system has been recognised in successive reviews, most recently the *Henry Review* (2010), the *Business Tax Working Group* (2012) and the *Treasury Scoping Paper on Risks to the Sustainability of Australia's Corporate Tax Base* (2013).

The risks to the revenue are regularly identified and addressed following consultation between the Government, the Treasury, the Australian Taxation Office (ATO), business, advisors and taxpayers. Recent examples include the changes to Australia's transfer pricing provisions, the thin capitalisation regime and the general anti-avoidance provisions (Part IVA).

- *Public interest in the Australian business tax system has increased in recent years.*

In the wake of the global financial crisis and existing or increasing fiscal budget deficits in many countries, there has been increased focus from governments and the community on ensuring that taxpayers contribute an 'appropriate' level of tax.



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It is important that any discussion concerning the future of Australia's business tax system be evidence-based, balanced and measured. It must also recognise the tax system's role in attracting and retaining foreign and local investment for the benefit of the Australian economy and all Australians. Accordingly, a holistic approach is required.

- *The role of tax advisors as intermediaries.*

KPMG's Global Code of Conduct and Principles for a Responsible Tax Practice, attached as Appendix 2, emphasise that the actions of our professionals have a public dimension. We respect the importance of the communities in which we operate. In serving the needs of our clients, we highlight the need to preserve the objectivity and judgment of our people and the needs of the communities in which we operate.

KPMG provides services that anticipate and respond to the changing needs of clients in changing business environments. For example, our clients increasingly ask us to help them develop, document and demonstrate their tax risk management and corporate governance frameworks. An increasing number of taxpayers are seeking to ensure that the tax positions they are taking are consistent with maintaining their reputation and brand, their values and principles of corporate and social responsibility.

A key value of our work is to assist clients to deal with the complexities and demands of a sophisticated tax system. This requires interpretation and judgment as legislation cannot anticipate the impact of all business transactions and evolving precedents. The professionalism of our work provides confidence to our clients and to the tax authorities. In areas of material uncertainty we encourage dialogue between clients and the ATO. This dialogue is valued by both clients and the ATO, and this transparency is another building block for confidence in the tax system.

In 2009, the Government reinforced the need to have appropriate assurances around the role of tax intermediaries and enacted the *Tax Agent Services Act 2009* (TASA). This legislative code of conduct supplements KPMG's framework.

KPMG has a proud history of contributing and participating in the debate about tax policy matters affecting the community in which we operate. KPMG is pleased to refer the attached submission to the Committee for consideration.

Yours faithfully

KPMG



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Appendix 1: KPMG Submission

The adequacy of Australia's current laws¹

It is the view of KPMG that Australia has comprehensive tax laws dealing with corporate tax and the robustness of these laws is widely recognised.

That Australia has comprehensive tax laws is well evidenced in the detailed analysis and research undertaken by the *Henry Review* and published in Part 2 of the Final Report – Detailed Analysis (Volumes 1 and 2) on 2 May 2010. It is anticipated it will again be recognised during the Government's White Paper process.

Since 2010 there has been ongoing refinement of the Australian tax system. KPMG's observations are that recent changes to the tax laws have resulted in further robustness. The tax system has been further enhanced via the expansion of the network of treaties and information access arrangements.

In addition, the Final Report of the *Business Tax Working Group*, dated 1 November 2012, and the *Treasury Scoping Paper in relation to Risks to the Sustainability of Australia's Corporate Tax Base* (2013), also conclude that Australia's corporate tax system is sound.

In regard to the robustness of the corporate tax system, we specifically note the following:

- 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 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 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.

¹ Unless otherwise stated, all references are to the Income Tax assessment Act 1936 or 1997.



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- 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 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.

Importantly, the ATO's submission to the Committee states that '[a] suite of indicators generally suggests companies are paying the income tax required under Australia's tax laws.'²

In summary, these features demonstrate that Australia's corporate tax framework is fundamentally sound and that both the ATO and the government of the day respond quickly and effectively to risks to the revenue base.

Key issues in relation to the initiative of the Organisation for Economic Co-operation and Development (OECD) on Base Erosion and Profit Shifting (BEPS) include:

- What level of economic activity should create a taxable presence in Australia? This debate is driven by the evolution of digital business platforms. KPMG recognises that this may be a double edged sword. Expanding the creation of a taxable presence internationally could adversely affect Australian multinationals and consequently result in income currently taxed in Australia being taxed overseas.
- The application of GST/VAT to Business-to-Business (B2B) supplies and Business-to-Consumer (B2C) supplies having regard to OECD guidelines emerging from the work on the taxation of the digital economy.
- The treatment of hybrid instruments and entities, having regard to our current rules for hybrid instruments and entities but also the proposed legislative amendments and the work of the Board of Taxation in this area.
- The proposals for country-by-country reporting and the standardisation of transfer pricing documentation (including the preparation of a master and local file).
- The treatment of financing costs in a multinational enterprise, acknowledging that our thin capitalisation regime has been recently strengthened as noted above.

² Page 34 of the 'ATO Submission – Senate Economics References Committee'.



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- The CFC rules in Australia will need to be reviewed once the OECD's current program of work has finished.

The United Kingdom (UK) has proposed the introduction of a Diverted Profits Tax regime that seeks to target profits earned in low tax jurisdictions pursuant to arrangements at odds with economic substance. There has been discussion as to whether Australia should adopt a similar measure.

KPMG agrees that it is appropriate for governments to be examining arrangements where tax outcomes do not align with the underlying economic substance. The first step however, is to consider whether Australia's existing tax laws already address these issues. If not, it may be more appropriate to strengthen existing laws rather than introduce a new law. In the context of the OECD's BEPS work, unilateral actions do add complexity and may inhibit inbound investment.

Australia is a capital importing country. At the end of the calendar year 2011, foreign parties had invested nearly twice as much in Australia as Australians had invested overseas. The case for reforming Australia's current tax laws to deal with emerging threats must take appropriate account of international competition for global capital flows. Moreover, any legislative change should be proportionate, with appropriate transitional arrangements. International investors, like domestic businesses, value certainty.

Any need for greater transparency to deter tax avoidance and provide assurance that all companies are complying fully with Australia's tax laws

Two types of transparency are relevant here: taxpayer/ATO transparency and taxpayer/community transparency.

With respect to taxpayer/ATO transparency, the ATO already receives a significant volume of information about the domestic and international operations of taxpayers. Sources of that information include International Dealings Schedules, Reportable Tax Position schedules and the Private Rulings System.

The ATO's submission to the Committee confirms that there are already very high rates of taxpayer/ATO interaction in the Public Groups and International (PGI) segment and with respect to cross-border related party dealings in general.

In addition, by virtue of the OECD BEPS program and other global and domestic initiatives, the ATO will likely have:

- Access to country-by-country reporting.
- Access to standardised master/local transfer pricing documentation.
- Greater information exchange powers.
- A common reporting standard (under the exchange of information).
- Frequent interactions and co-operation with other countries' tax authorities.



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Transparency is also important for the wider community. The community is clearly an important stakeholder in the Australian tax system, with an active and appropriate interest in ensuring that all taxpayers contribute an 'appropriate' level of tax.

With respect to taxpayer/community transparency, the tax transparency measures enacted in the *Tax Laws Amendment (2013 Measures No. 2) Act 2013 (Cth)* will provide the public with greater information about the total income, taxable income and income tax payable by large corporations. This is again evidence of our tax laws being at the forefront of most comparable tax authorities.

These measures represent a low-cost way for the ATO to provide greater information to the public. Ultimately the ATO is simply required to publish information it already has by virtue of the lodgement of the tax return of a company. However, the release of this information cannot be viewed in isolation, as the nature of the information means it is of limited use and may be misleading if used to compare taxpayers with different histories or which operate in different industries. The information requires contextualisation and reference to the specific factors relevant to the taxpayer to which it relates.

Making information publicly available without adequate explanation risks impairing confidence in the Australian corporate tax system. It is incumbent on the ATO to provide general (non-taxpayer specific) comments regarding the significance of the disclosures and their potential shortcomings, particularly if the information is complex.

Any transparency measures will likely affect taxpayer behaviour, for example, by prompting taxpayers to produce sustainability/transparency reports that expand on their tax principles or policies and on total taxes paid. These behavioural consequences should be observed for a reasonable period of time before considering whether greater taxpayer/community transparency is needed.

The ATO's submission to the Committee included many insightful metrics. To increase public trust in the tax system, these could usefully be embedded in the Commissioner of Taxation's Annual Report or made available on the ATO website, as is currently being proposed by the ATO.

The opportunities to collaborate internationally and/or act unilaterally to address the problem

KPMG regards international collaboration as essential at both the Government and ATO level.

Some of the gaps identified by the OECD BEPS initiative require multilateral action if they are to be addressed comprehensively. For example, if countries implement changes to the taxable presence of multinationals, this could impact on the level of tax being paid in Australia, with foreign jurisdictions seeking to tax revenue that was previously subject to tax in Australia.

Moreover, even after the OECD BEPS initiative has been completed, regular cross-border exchange of information will be vital in monitoring the continued integrity of the international tax framework.



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KPMG acknowledges and supports the active participation to date in the OECD BEPS action by Treasury and the ATO, and the Government's broader involvement during Australia's G20 Presidency.

As the OECD BEPS project moves to the implementation phase, the Government must determine what type of action is appropriate for Australia before enacting suitable domestic legislation. KPMG recommends that the Government set a clear timeline for consultation and implementation.

The OECD BEPS initiatives are needed but require the actions taken to be applied consistently across jurisdictions. The changing nature of business means that tax laws must be continually reassessed to reflect current and, to the extent possible, future business models and the role of technology.

The implementation phase introduces the risk of integration issues, complexity and uncertainty, particularly if countries adopt different views regarding the appropriate allocation of profits between jurisdictions.

The Government continues to have a vital role to play in ensuring, wherever possible, that there is some global consistency in the individual responses to the OECD BEPS initiatives amongst the G20 and other participating nations.

As part of this process, the mutual agreement procedure in Australia's double tax agreements will need to be streamlined (and competent authorities well briefed) to help multinationals confirm the allocation of profits between the jurisdictions in which they operate. The ATO has proactively started streamlining and refining its competent authority framework.

Increased international collaboration may also enhance the efficiency of the corporate tax system. It should not be seen solely as a means of targeting tax avoidance. From the perspective of multinational corporations, increased international collaboration may help reduce the compliance burden. Maintaining a single transfer pricing master file is one example.

KPMG recognises the potential benefits to the ATO and other tax authorities of introducing global tax reviews and advance pricing agreements. Under this approach, interaction with revenue authorities and the provision of information will take place on a global level, rather than in each relevant jurisdiction. We recognise however, the considerable challenges associated with this, including the time it may take to reach an international consensus.

It is critical that the ATO be supported with the appropriate skill, systems and level of resourcing to deal with the increased information flow.

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

KPMG 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 tax litigation.



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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 given matter proceed to court, or would another dispute resolution process be more efficient?

KPMG's observations on the ATO's performance and capability are:

- As part of its 2012-13 compliance program, the ATO assured 74.8% of company corporate tax base (i.e. \$44.8 billion of the \$66.9 billion total tax paid) through its engagement with taxpayers, and assured (or is assuring) 60% of all cross-border related party dealing through various compliance activities.³ These figures indicate a very high rate of ATO/taxpayer interaction.
- The ATO continues, and is increasing, the application of a risk-based approach to ensuring compliance with the Australian corporate tax system.
- KPMG supports the ATO's pilot program using External Compliance Assurance Processes (ECAP) to more efficiently collect the information which the ATO requires for its compliance activities. We acknowledge the concerns regarding potential conflicts of interest and the need for safeguards if ECAP is rolled out more widely.
- The ATO's adoption and increasing use of alternative dispute resolutions processes are welcome. The use of such processes could be expanded to streamline case management.
- The ATO already has both multilateral and unilateral profit shifting investigations underway and has indicated that more international tax disputes will go to court in the second half of this year.
- Australia has already legislated a number of tax changes directed at potential base erosion and profit shifting activity because of ATO proactivity in investigation and litigation.

Later this year, the OECD BEPS action plan process will be completed. The resources required to consider, recommend and implement any tax changes will then shift more markedly to a country level. KPMG acknowledges that there are already divergent views on what should be the appropriate Australian response and this will ultimately be a matter for the Government. However, it would be prudent to consider allocating additional Treasury and ATO funding for an OECD BEPS response plan in the coming Budget.

Whilst not directly related to the performance and capability of the ATO, KPMG considers that additional funding is also warranted, having regard to other domestic tax policy initiatives. When the Government was elected, it reviewed 92 announced but un-enacted tax and superannuation measures. While the Government indicated that the majority of the measures to proceed were to be enacted in 2014, several significant measures have still not been implemented. The associated uncertainty is not conducive to creating business and consumer

³ Paragraph 59 of the 'ATO Submission – Senate Economics References Committee'



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confidence. The backlog is due, at least in part, to resource constraints. The OECD BEPS project and the prospect of domestic tax reform are likely to further increase the workload of Treasury's tax policy area and the Office of Parliamentary Counsel, as well as the ATO. KPMG therefore encourages the Committee to take a more holistic view when considering the adequacy of existing resources.

The role and performance of the Australian Securities and Investments Commission (ASIC) in working with corporations and supporting the ATO to protect public revenue

KPMG notes that ASIC has historically supported the ATO, for example, in addressing Phoenix operators and notes the contents of the ASIC submission to the Committee.

KPMG acknowledges that where taxpayers:

- are exempt from preparing and/or lodging financial statements (for example, because they are part of a larger group or have a grandfathering exemption); or
- prepare financial statements that exclude information such as related-party transactions (for example, because they have appropriately assessed themselves as a non-reporting entity),

this could detract from the availability of useful information in the financial statements provided to the ATO.

It is KPMG's view that the prioritisation of financial reporting requirements to address the ATO's information needs, and whether this should take priority over the assessment of the information needs of the capital markets, which is the main purpose of financial statements, is a question that must be approached with caution.

In addition, KPMG acknowledges that access to financial statement information (preferably in a standardised electronic format) leveraging the ASIC lodgement processes would assist the ATO's risk assessment processes, for example, in running its risk filters over taxpayer data.

KPMG notes that whilst electronic filing with ASIC is currently available, it is understood that there is a low take up rate, no doubt in part due to the transitional costs of changing to electronic filing.

In 2010 the Government introduced Standard Business Reporting (SBR), a standard approach to online or digital record-keeping, to simplify business reporting obligations. Government agencies, businesses, intermediaries and software developers are progressing SBR with the ATO, intending it to be available for tax return lodgements in 2015/16. It is yet to be determined if and when SBR is to be mandatory and it does not address the question of ATO access to financial statements in an electronic format.

KPMG notes the UK HM Revenue and Customs has developed an iXBRL format for its purposes and we understand that New Zealand is also proposing increased electronic interaction between its Inland Revenue Department and taxpayers.



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Technological advancements will enable the ATO to more efficiently (e.g. on a real time basis) access greater amounts of business data. In assessing processes to be adopted, the ATO will need to factor in the cost/benefit of all the different options available and ensure that the compliance burden is minimised.

Any relevant recommendations or issues arising from the Government's White Paper process on the 'Reform of Australia's Tax System'

KPMG has always contributed to the ongoing reform of the Australian tax system. As you will be aware, Treasury commissioned KPMG to undertake a rigorous economic analysis of the economic costs of the Australian tax system (published March 2010), as part of the *Henry Review*.

The Final Report of the *Business Tax Working Group*, dated 1 November 2012, and the *Treasury Scoping Paper on Risks to the Sustainability of Australia's Corporate Tax Base*, issued in July 2013, are also appropriate references in considering tax reform in Australia.

KPMG intends to provide a submission as part of the White Paper process. Initial thoughts can be found in our April 2014 publication, *Tax reform for our future success* available at www.kpmg.com.au

Conclusion

Internationally, there is a growing public interest in the effectiveness of the tax system. Australia is no exception. A debate that is evidenced-based, balanced and measured is invaluable in maintaining public trust in the tax framework and system.

Australia already has a comprehensive and robust corporate tax system administered by a capable regulator, being the ATO. The finalisation of the OECD BEPS action plan will require the Australian Government to develop its own response. Australia's response to emerging global tax issues should not be unilateral but aligned with the Government, the Treasury and the ATO investment to date in relation to the multilateral G20 and OECD BEPS initiative.

Any reform of the Australian tax system must take due account of international competition for both global capital and revenue flows. Moreover, should any legislative change be necessary, it must be proportionate and supported by appropriate transitional arrangements. International investors, like domestic business, value certainty.

This is the best way to maintain and grow our economy, encourage overseas investment in Australia and enhance the ability of Australian registered multinationals to compete globally, whilst deterring and preventing threats to Australia's revenue base.

KPMG fully supports, and will continue contributing to, the ongoing reform of Australia's current tax laws, particularly in dealing with emerging global tax issues and responding to the Government's White Paper, to ensure the future success of Australia.



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Appendix 2: KPMG's Global Code of Conduct and Global Principles for a Responsible Tax Practice

KPMG International has a comprehensive, robust and publicly available Global Code of Conduct setting the standards of ethical conduct for everyone at KPMG member firms which can be found at <http://www.kpmg.com/global/en/about/governance/values-culture/pages/our-values.aspx>

In addition, to support our tax strategy, the International Tax Steering Group – the governing body of KPMG's global practice – has approved a set of principles to affirm the way we serve our clients, support our people and contribute to the communities in which we live and work.

Our Principles for a Responsible Tax Practice (set out below) bring to life KPMG's values and Global Code of Conduct in a way that is meaningful for the everyday situations we face as tax professionals. They recognise that the value we add to our clients is built upon the quality of our technical skills but is differentiated by the way we help them appreciate the long-term consequences of their actions.

The KPMG Code and Principles clearly state that we should act lawfully and with integrity and expect the same from our people, clients and other parties with whom we work.

The Code of Professional Conduct (Code) is legislated in TASA and provides the professional and ethical standards required of registered tax agents and BAS agents. The Code defines the duties that agents owe to their clients, the Tax Practitioners Board (Board) and other agents.

The core principles of the Code relate to:

- Honesty and integrity.
- Independence.
- Confidentiality.
- Competence.
- Other responsibilities.

It is against this extensive framework of stringent external and internal standards that KPMG provides services to our clients; and thereby contributes to the common good of our community by ensuring that our work provides confidence to our clients, the ATO and all stakeholders in the Australian tax system. Our Principles for a Responsible Tax Practice:

Your actions as a tax professional have a direct bearing on how KPMG is viewed by our clients, our people and tax authorities around the world. An action taken in one country can have a consequence in another. In an interconnected world, it is important to demonstrate consistent behaviours across borders. Our principles remind us of the culture of professionalism that should guide us, both individually and collectively, in the judgements we make every day.



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The principles are set out below. Your senior tax partner will be working with you to enable the principles to be embedded in the way you carry out your day-to-day work.

- We act lawfully and with integrity and expect the same from our people, our firms' clients, tax authorities and other parties with whom we interact.
- We provide tax advice to our firms' clients to allow them to pursue their commercial objectives, respecting the needs of our people and the communities in which we operate.
- We maintain objectivity by seeking the facts and providing insight, consistent with our professional duties, in providing tax services to our firms' clients.
- We support a relationship with tax authorities based upon mutual trust and respect, which will enable constructive dialogue and responsiveness by all parties, in order to fulfil our responsibilities to our firms' clients.

Interpreting Our Principles

Tax professionals deal with laws and regulations on behalf of their clients, which can be shaped by policy makers at home and abroad. Expected behaviours are constantly shifting, influenced by social expectations and economic necessity.

Our principles are a constant. However, it is recognized that further guidance may be required. This could be to help interpret the local understanding of a term, to reconcile with broader member firm commitments or to fit within a legal or regulatory framework that binds tax professionals in that country or jurisdiction.

If you are having difficulty interpreting the principles, please speak to your Senior Tax Partner as every member firm has been asked to consider the types of behaviours and actions that that would support each principle in their jurisdiction.

Where any provision of the principles may be interpreted as differing from an applicable law, regulation or professional standard or member firm policy, the more restrictive should apply

Getting Help

When to get help

You are encouraged to seek advice if you are unsure about an appropriate legal or ethical course of action. Situations may include when:

- Applicable policies seem difficult to interpret
- Relevant laws or professional practice rules are complex



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- You have limited experience dealing with the subject matter
- Differences of opinion make the course of action unclear
- Potential actions or decisions make you uncomfortable
- You observe or suspect unethical or illegal activity

Where to get help

There are many avenues available to tax professionals to get help, and you should select the one that is most appropriate given the situation. Remember that KPMG or professional standards may require consultation in certain situations. A supervisor, line manager, or performance manager is a good place to start. Other resources available within your member firm include the engagement partner, human resources professionals, internal legal counsel, ethics and independence partner, or risk management partner.

Additionally, you can contact regional or global people for help or advice, or to report concerns, when necessary. These resources include your regional or country risk management partner, your functional risk management partner and Global Risk & Compliance.

Partners and employees are also encouraged to consult their member firm Tax Code of Conduct, if applicable, which may provide additional guidance and resources.