

ATO Submission – Senate Economics Reference Committee

Inquiry into corporate tax avoidance
and minimisation

2 February 2015



ATO Submission – Inquiry into corporate tax avoidance and minimisation

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EXECUTIVE SUMMARY

- 1 Most corporates pay the tax they are required to under Australia's law. Some private groups, linked to wealthy individuals with complex group structures, display more aggressive tax behaviours and characteristics. Some multinational enterprises engage in complex profit shifting structures. These present tax avoidance risks that threaten the level playing field of business.
- 2 The ATO is an active and visible regulator with a well-educated and experienced workforce administering internationally respected law. We work co-operatively with other revenue authorities and make risk-based decisions about how our resources are used to administer the tax system. Recent staff reductions have been managed to ensure there is no material impact on our frontline expertise or capability.
- 3 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 ATO is supporting the G20/OECD to drive 15 action items to address base erosion and profit shifting. We are also undertaking tax gap measurement to assist in providing another insight into the health of the tax system over time.

SECTION 1 – INTRODUCTION

- 4 This submission deals with corporates' compliance under the current law.
- 5 For the purposes of this submission we are focusing discussion on corporates with an annual turnover of more than \$2 million, although section 2 of this submission does provide demographic data for the whole corporate population.
- 6 This submission is focused on income tax only and matters covered elsewhere, for example the Tax Disputes Inquiry by the House of Representatives Standing Committee on Tax and Revenue, are touched on only briefly. We have had the opportunity to view the Australian Securities and Investments Commission's submission which addresses in detail one of the terms of reference.
- 7 Our submission addresses the terms of reference within the broader context of the ATO's role of administering the overall corporate income tax system and the ATO's role of assuring that companies meet their obligations under Australia's tax laws.

SECTION 2 – CORPORATIONS IN AUSTRALIA

Over 850,000 companies lodged a tax return in 2012-13 and paid nearly \$67b in income tax.

The vast majority of these companies are small with a turnover under \$2 million per annum, paying 11.6% of total corporate income tax.

Over the last few years we have seen an increasing share of corporate income tax from the financial services and mining sectors, accounting for 50% of total corporate income tax in 2012-13. Current economic conditions are impacting revenue from the mining sector.

CORPORATE DEMOGRAPHICS

- 8 In 2012-13, 864,476 corporate entities lodged a company tax return.¹ Over three quarters of these (670,564) are classified as micro companies (income of less than \$2 million per annum).

Table 1: Count of corporate entities by entity size, 2012-13

| Label | Annual turnover | Count | Proportion % | Net Tax \$b | Proportion % |
|-----------------|-------------------------------|----------------------|--------------|-------------------|--------------|
| 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 | | 864,476 [†] | 100.0 | 63.3 [‡] | 100.0 |

Source: Company income tax return²

[†] The column total is 864,475. The difference represents one company return that was lodged as a refund of franking credits.

** Companies that report nil or zero income are not classified by size but remain in the overall population.

[‡] 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).

¹ 2013 is the latest income year with complete lodgment and is used throughout this section. A corporate entity is defined as any entity that lodges a company tax return.

² Income tax return net tax (tax payable) data will differ from cash collections (revenue).

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- 9 Most corporate entities are private. In 2012-13, 90.6% of corporate entities were classified as private, 7.6% as strata title and 1.1% as publicly-listed companies.

Table 2: Count of corporate entities by entity type, 2012-13

| Description | Count | Proportion % |
|--------------------------------|----------|--------------|
| Private | 783,531 | 90.6 |
| Strata Title | 66,064 | 7.6 |
| Public | 9,081 | 1.1 |
| Cooperative | 2,504 | 0.3 |
| Non-profit | 1,700 | 0.2 |
| Limited Partnership | 1,043 | 0.1 |
| Public Trading Trust | 396 | <0.1 |
| Corporate Unit Trust | 46 | <0.1 |
| Pooled Development Fund | 32 | <0.1 |
| FHSA³ Trust | 2 | <0.1 |
| Total | 864,476† | 100.0 |

Source: Company income tax return

†The column total is 864,475. The difference represents one company return that was lodged as a refund of franking credits.

- 10 Corporate entities are predominantly service based, the largest sector being financial services at 18.7%, followed by professional and scientific services (15.2%) and rental, hiring and real estate services (12.1%). Construction accounts for 12.3%, retail and wholesale trade 10.4% and manufacturing 5.3%. Less than 1% of corporate tax entities operate in the mining sector.
- 11 The majority of corporate entities are Australian headquartered (98.5%), with the remaining 1.5% foreign headquartered. However, 45.3% of large corporate entities are classified as foreign headquartered.
- 12 In 2012-13, 96% of corporates had their tax return prepared and lodged via a registered tax agent, 66% of large companies (turnover greater than \$250m) lodged their income tax return through a registered tax agent. The other 34% would be using their in house tax team to do the lodgment – although a registered tax agent would likely have some involvement in the preparation of the return. In 2012-13, 74.2% of corporate entities lodged their income tax return and business activity statements on time and 86.3% paid their income tax liability on time. For large businesses, 95.1% of

³ First Home Saver Account.

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tax was paid on time, with 98.4% paid within 90 days of the due date (by value) and 96.9% of tax was paid on time, with 99.2% paid within 90 days of the due date (by number).⁴

CORPORATE TAX REVENUE

- 13 In 2012-13, corporate tax revenue collections totalled \$66.9 billion, 28.3% of the \$236.6 billion in total income tax revenue, making it the second largest contributor to the tax revenue base after individuals.
- 14 Corporate tax revenues increased from \$36.1 billion in 2003-04 to \$66.9 billion in 2012-13. This average annual growth rate of 7.1% exceeds the growth rate of most other taxpayer groups over the same period.
- 15 Corporate tax revenue is highly concentrated from multiple perspectives.
 - Large⁵ companies accounted for 61% of net tax.
 - Approximately 33% of the corporate tax revenue is paid by private companies. Of this, the 100 largest private companies contribute 3.4% of the total corporate tax revenue and 10.4% of the private company corporate tax revenue.
 - For public companies, those listed on the ASX account for 40.8% of net tax. The largest 200 ASX listed companies by market capitalisation⁶ contribute 97% of the net tax of all ASX-listed companies and the top 50 accounts for 82%. The financial services and mining sectors accounted for over half of the total corporate income tax revenue.
 - Even at the large end of the population, the majority of tax is paid by a few large companies, i.e. of the largest 500 companies in Australia, the top 50 account for 72% of the tax paid.

Trends in tax revenue by industry

- 16 The mining sector's share of corporate tax revenue increased from 10% in 2006 to 24% in 2011-12 before reducing to 18.7% in 2012-13. Growth in mining sector tax

⁴ Figures as at end September 2014 (latest available)

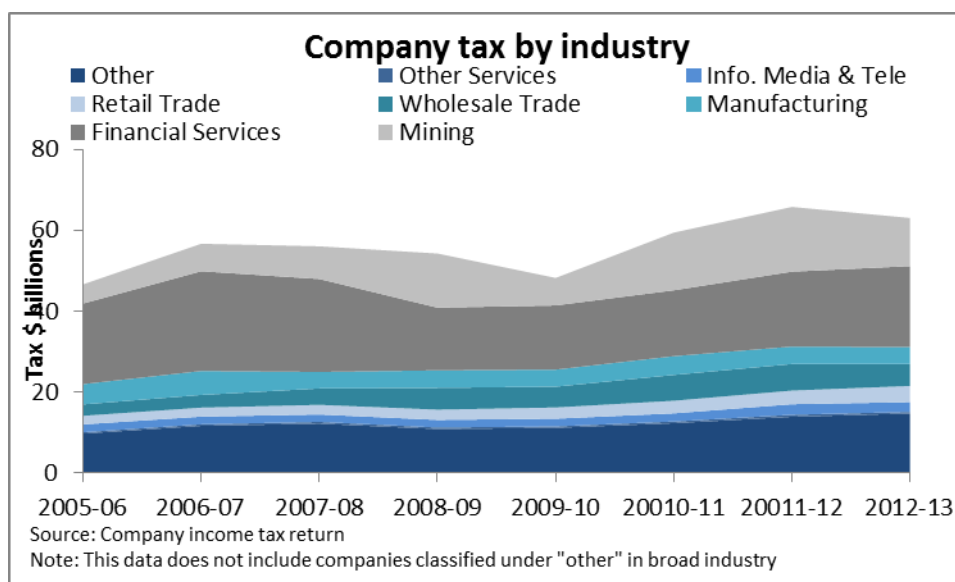
⁵ Turnover greater than \$250m

⁶ The largest 200 listed companies excludes listed unit trusts, stapled groups and other non-corporate enterprises. Market capitalisation as at 28 November 2014.

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revenue has been driven by high commodity prices, which have fallen by 23.3% since the start of 2014.⁷

Figure 1: Company tax by industry



- 17 Tax revenue from the financial sector has contracted from a peak of \$24.6 billion in 2006-07 to \$15.4 billion in 2008-09, before recovering to \$20.0 billion in 2012-13. Over the last three years, tax revenue from the retail sector has grown significantly while tax revenue from the manufacturing sector has declined.

Table 3: Net income tax by selected industries 2011 - 2013 (\$ billion)

| Industry | 2010-11 \$b | 2011-12 \$b | 2012-13 \$b |
|-----------------------|-------------|-------------|-------------|
| Financial services | 16.3 | 18.5 | 20.0 |
| Mining | 14.3 | 16.0 | 11.9 |
| Wholesale trade | 6.4 | 6.6 | 5.4 |
| Manufacturing | 4.6 | 4.3 | 4.2 |
| Retail trade | 3.1 | 3.4 | 4.0 |
| Info. Media and Telco | 2.0 | 2.6 | 2.4 |
| Other services | 0.4 | 0.5 | 0.4 |
| Other | 12.4 | 13.9 | 14.8 |
| Total | 59.4 | 65.8 | 63.1 |

Source: Company income tax return

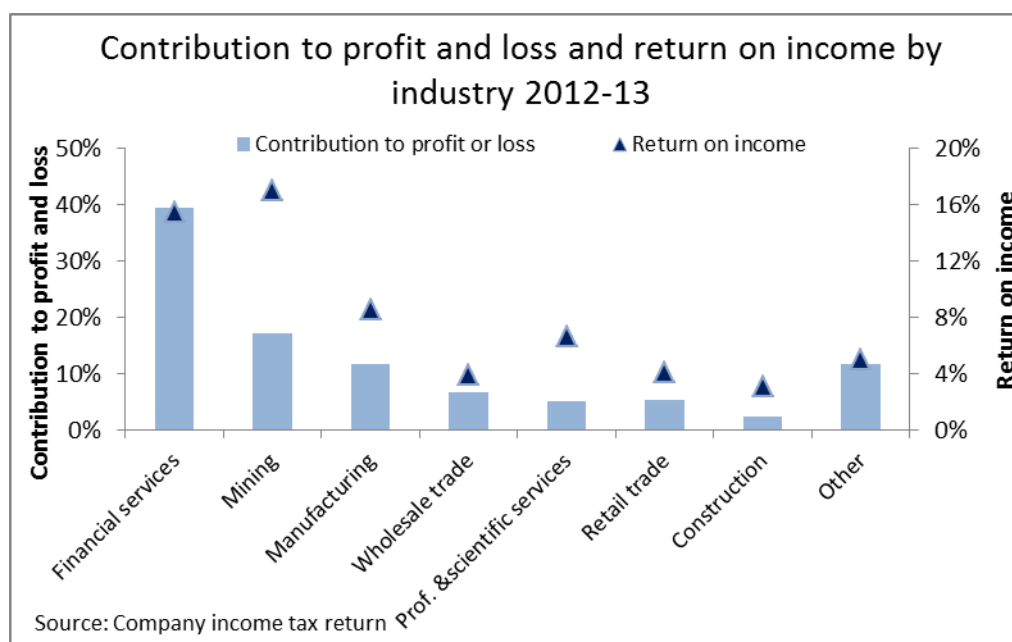
⁷ RBA index of commodity prices, non-rural commodity prices in A\$, change from January 2014 to November 2014.
Source: <http://www.rba.gov.au/statistics/frequency/commodity-prices.html>

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INCOME, PROFITS AND LOSSES

- 18 Corporate entities reported \$2.7 trillion in income, \$308.4 billion in profits and \$79.9 billion in losses in 2012-13. Reported profits have grown by an average of 8.9% per year since 2006, which includes the effect of the mining boom, but this is partially offset by the impacts of the global financial crisis (GFC). The GFC is a contributor to the growth in reported losses, which have grown by an average of 35% per year since 2006.

Figure 2: Profit and loss return by industry



- 19 Total profits are dominated by the financial services and mining sectors, reflecting the high returns in these industries. In 2012-13:
- The financial services sector is the largest industry, accounting for 21.4% of gross income and contributing 39.4% of corporate profits.
 - The mining sector is the fifth largest industry by gross income, behind wholesale trade, manufacturing and retail trade. While it accounts for 8.5% of gross income, this industry generates 17.2% of all corporate profits.
- 20 The mining sector accounted for one quarter of losses, reflecting the high risk nature of exploration, but losses are also a feature in the financial services (16%),

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manufacturing (12%) and construction (8%) sectors, particularly across small and micro companies.

- 21 In 2012-13, 148,738 companies utilised \$18.1 billion of prior year tax losses to offset against current year taxable income. The balance of carried forward losses has risen steadily from \$134.9 billion in 2005-06 to \$264.3 billion in 2012-13.
- 22 The total pool of tax losses carried forward for all companies was \$264.8 billion in 2012-13, representing 80% of the total tax losses pool, with over 60% of that value in public companies. Over the last five years, losses utilised by companies has averaged less than 9% of the pool. Utilisation is subject to satisfaction of statutory tests, the availability of taxable income and other controls in the system. Other examples of controls include; Consolidation available fraction rules which limit the amount of tax losses a head company can claim in any given year, the availability of credits offsets and/or rebates, and the fact that some companies want to pay tax to generate franked dividends for shareholders – so dividend policy can be a natural limiter.

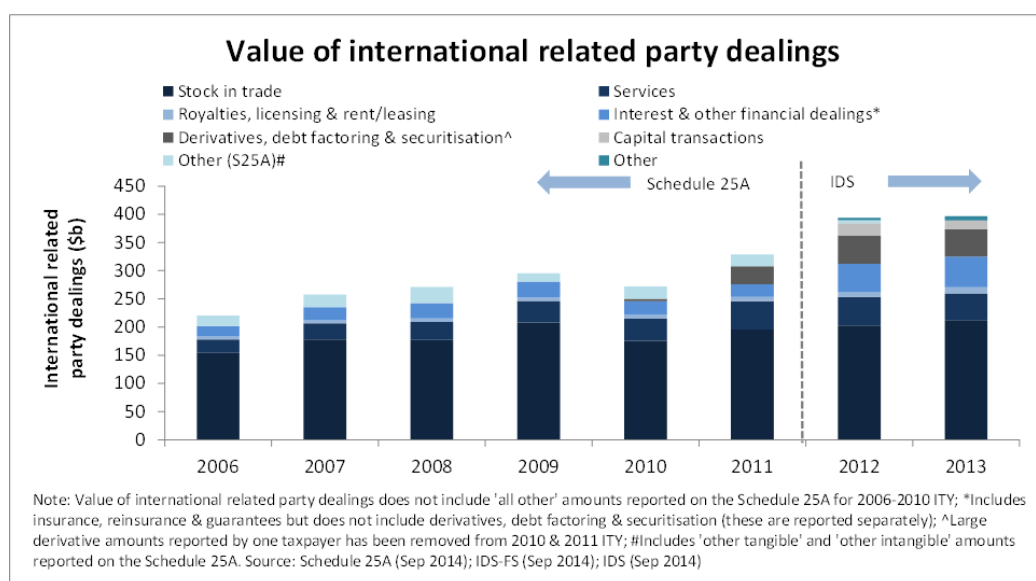
GLOBALISATION

- 23 The Australian economy is a small, open economy accounting for approximately 2% of global GDP and trade. The rapid pace of globalisation resulting from improvements in technology and reduced barriers to international trade, and the adoption of global value chain approaches to operations has seen the Australian economy become increasingly interconnected with the global economy across all markets.
- 24 International related party dealings (IRPDs) represent the flow of cross border transactions between related entities (in the same corporate group). For 2012-13, IRPDs totalled \$388.4 billion. Removing derivatives, debt factoring and securitisation, this figure falls to \$326.7 billion, which accounts for over half of \$599.6 billion in total trade.
- 25 The value of IRPDs is highly concentrated within the largest 30 corporate entities which account for approximately 50% of total IRPDs.

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- 26 Stock in trade accounted for \$209.4 billion of IRPDs, followed by interest and other financial dealings at \$52.2 billion, derivatives, debt factoring and securitisation at \$46.7 billion, capital transactions at \$13.2 billion and royalties, licensing, rental and leasing services at \$10.8 billion.

Figure 3: Value of international related party dealings



- 27 Related party flows by country broadly reflect actual trade flows. 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 (\$100.4 billion), United States (\$41.3 billion), Japan (\$31.5 billion), Great Britain (\$23.2 billion) and Switzerland (\$15.6 billion). Some of the differences between Australia's trading partners (National accounts) and IRPDs⁸ will be due to differences in the way trade flows are captured, and may also reflect the use of offshore hubs⁹ by multinational enterprises. The large volume of related party flows with Singapore and Switzerland do not correspond with trade flows as these countries are commonly used as financing hubs for Asia and Europe respectively.

⁸ IRPD statistics are sourced from ATO internal data, specifically, the International Dealings Schedule (post 2011) and Schedule 25A (up to 2011).

⁹ Some corporates have established companies offshore which have taken on marketing, financing or procurement activities that were previously undertaken in Australia, or have consolidated the ownership of intellectual property into one country. The primary tax questions are around whether the pricing methodologies used to support the remuneration for these activities reflect a genuine commercial outcome. The ATO is reviewing a number of these arrangements.

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- 28 For 2012-13, 12,825 foreign-owned taxpayers lodged income tax returns and reported total income of \$758.7 billion, taxable income of \$50.1 billion and income tax payable of \$12 billion. Foreign-owned taxpayers operate across all industries except for superannuation and are significantly represented in both the manufacturing and sales and services industries.¹⁰

PRIVATE COMPANIES

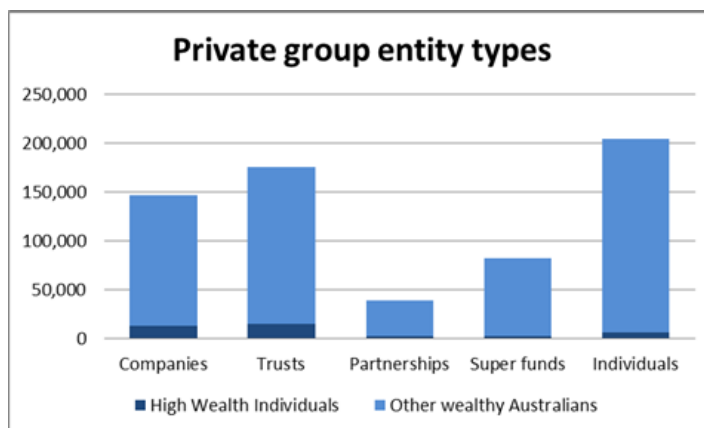
- 29 Private companies contributed to 33% (\$22 billion) of the total corporate tax paid in 2012-13. Of this almost 70% was paid by private companies with turnover greater than \$2 million.
- 30 There are 147,000 private companies associated with 220,000 private groups linked to 119,000 Wealthy Individuals (resident individuals who, together with their business associates, control more than \$5 million in net wealth). Of this approximately 2,800 are considered High Wealth Individuals (HWIs), i.e. a sub-set of Wealthy Individuals who control more than \$30 million in total assets.
- 31 Wealthy Individuals (WI) contribute 12% of the overall total tax reported for individuals and businesses, while representing only 1% of this population. HWIs account for 2.5% of the overall tax paid by individuals and businesses while representing only 0.02% of the population.
- 32 Wealthy individuals and their private groups often have complex arrangements and utilise flow-through entities such as trusts and partnerships in addition to companies. On average High Wealth Individual group structures consist of five companies, five trusts, one Self-Managed Super Fund (SMSF) and one partnership. Other wealthy individual group structures on average consist of one company and one trust, with two thirds including an SMSF and one third including a partnership. The top 80 HWI groups consist of more than 50 entities.

¹⁰ There are a number of entities currently classified as active under ATO system rules. Those rules are under review and we anticipate the number will reduce significantly particularly in relation to foreign-owned businesses.

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Wealthy individual private group entity types

Figure 4: Private group entity types for 2012-13



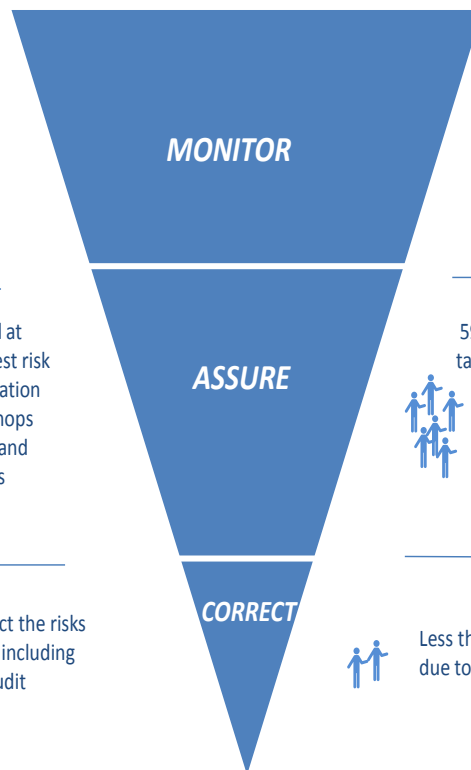
SECTION 3 – CO-OPERATIVE COMPLIANCE

Risk detection activities

A range of risk assessment activities to detect non compliance – including running data analytics or risk models over returns /schedules / external data sources, and intelligence gathered from regular engagement with taxpayers

A range of assurance activities targeted at those taxpayers identified as the greatest risk – including encouraging willing participation activities (ACA, PCR, restructure workshops APA, reportable tax position schedule) and traditional compliance activities such as reviews and audits

A range of treatment activities to correct the risks detected via our assurance activities – including adjustments of assessments after an audit



Population coverage

100% population is risk assessed



Public groups

Private groups

Internationals

59% corporate tax base (of the total amount of tax paid) is covered by ATO assurance activities



- 100 taxpayers from the ASX 200
- 83% large market
- 60% of all cross border transactions



Less than 5% of the population requires correction due to non compliance

Based on our intelligence, analysis and activities we know that the majority of large corporates pay the right amount of tax within the law.

OVERALL APPROACH

- 33 Our tax system is based on self-assessment and voluntary compliance. Our overall approach to administering the corporate tax system is based on cooperative compliance to support willing participation. We aim to have an open and cooperative relationship with large and small companies to support and assist them in meeting their tax obligations.
- 34 Our work with companies is guided by the principles in the Taxpayers' Charter and the ATO's Compliance Model. We differentiate our approach and level of engagement according to our assessment of each company's risk categorisation. This allows us to focus our resources on key and emerging risks while maintaining a level of assurance about overall compliance of corporations in Australia.

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- 35 We consult, collaborate and co-design with large and small companies to support voluntary compliance and minimise compliance costs. We do this based on our understanding of tax law, the global tax environment, causes of non-compliance, the business environment and from a whole of tax system perspective. We are focused on providing certainty of tax outcomes in a timely manner, promoting an open dialogue and strong corporate governance, and supporting companies in assessing and managing their tax risks.

Relationships and transparency

- 36 Key elements of our approach are transparency, mutual respect and professional relationships with the various stakeholders (including corporates and their advisors).
- 37 Our taxpayer engagement is governed by the risk differentiation framework (RDF) as outlined at paragraph 45.
- 38 We have various stewardship groups, both technical and specific issue, and liaison and advisory forums that provide a platform for external consultation and collaboration. These are supported by close working relationships with a number of State and Federal government agencies such as the Australian Securities and Investment Commission (ASIC), Australian Prudential Regulation Authority (APRA) and state revenue authorities.
- 39 We are committed to transparency; with transparency of both corporate and ATO approaches (to information and tax issues) critical to obtaining certainty, trust and assurance. We have seen improved corporate transparency with increasing numbers of taxpayers bringing issues to our attention and seeking assistance. The number of private ruling requests has increased by 30% since 2011 and the number of Advance Pricing Arrangements (APAs) in place has increased by 12% over the last 3 years. Each year we also receive a small number of voluntary disclosures and this has increased from three in 2011 to 14 in 2014.
- 40 We support international transparency through more timely and spontaneous exchange of information with our treaty partners, country by country reporting and the

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adoption of a common reporting standard (CRS). We are leading several multilateral initiatives in this regard.

Monitoring and assurance

- 41 To assist in detecting risk and providing assurance that corporates are paying the correct amount of tax, we monitor and analyse data from a variety of sources and through a variety of lenses at the whole of system (macro) and taxpayer (micro) levels. Our primary sources of data are tax returns/schedules and the intelligence we gain through our relationships and engagement with taxpayers. Parameters used to analyse the data include industry, risk topics (risk models), company life cycle, turnover and group structures.
- 42 For example, we analyse data based on:
- *Company characteristic* – i.e. whether the company is public, private or foreign. We are mindful of the varying reporting and regulatory requirements that apply to foreign, private and publicly-held companies.
 - *Taxpayer* – we use a risk differentiation framework (RDF) to segment taxpayers into higher consequence (largest taxpayers) and lower consequence, and tailor our approaches to monitoring and assuring income.
 - *Tax system risk* – we take different approaches to monitoring and assuring specific risks such as capital gains tax (CGT), profit shifting, or consolidation.
- 43 Other data sources include shared information from agencies such as ASIC, the Australian Bureau of Statistics (ABS), Australian Transaction Reports and Analysis Centre (AUSTRAC), tax authorities (domestic and international) and information in the public domain. The history of collaboration between ASIC and the ATO extends to joint analysis of issues relating to markets and revenue arising from mass marketed tax schemes in the 1990s. ASIC and the ATO have long cooperated to address mutual risks including: addressing offshore tax avoidance and evasion through Project Wickenby since 2006, up to the November 2014 establishment of the Phoenix Taskforce which allows the ATO, ASIC, and other federal agencies to monitor and deter phoenix activity.

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- 44 In line with international best practice the ATO uses risk-based approaches to ensure that our resources and efforts are focused on those taxpayers and issues posing the greatest risks to the tax system. We use data and analytics capability to better target monitoring and assurance activities and design new ways to make better use of taxpayer's natural data systems. For those relatively few taxpayers with whom we have more significant concerns, our approach will have more of an enforcement focus (e.g. audit, litigation).

RISK MANAGEMENT APPROACH

Public and foreign-owned companies

- 45 In considering which companies to review and the frequency and intensity of such reviews, we assess the relative likelihood of each company not meeting its tax obligations and the consequence of potential non-compliance using a risk differentiation framework model (RDF).
- 46 The table below shows results of this model over the last four years. Organisational realignments undertaken during the period mean that the population assessed varied from 1,100 large businesses in the years 2011 to over 33,000 in 2014. Assessments are point in time, with the process generally beginning in August each year using risk models applied to the entire population, combined with our professional judgment, knowledge and experience taking into account things such as historical tax performance and the strength of the company's corporate tax governance processes. Our focus on corporate tax governance has been strategic since a targeted letter campaign to the boards of selected companies in 2006 and continues with the RDF letters we issue to higher risk and key taxpayer companies.

Table 4: RDF risk ratings over four years

| 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 | 33252 |
| Total | 1113 | 993 | 905 | 33628 |

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- 47 We continually engage with higher risk and key taxpayers, i.e. higher consequence taxpayers, to review their tax affairs. This means we are regularly in contact with them to provide certainty on issues and risks as they arise, mostly before lodgment of the tax return. We also work closely with them where post-lodgment work is undertaken if issues cannot be resolved prior to lodgment. These taxpayers can access personalised services such as key client managers and the large service team to advance specific issues. We regularly meet face-to-face with these taxpayers to ensure we understand their changing business circumstances, their industry, their performance, possible areas of risk and uncertainty and, where needed, to agree on approaches to resolve issues where uncertainty exists. These taxpayers regularly access our early engagement interpretative assistance services which provide legally binding ATO advice on actual and proposed transactions.
- 48 Of our total higher consequence taxpayers, there are currently 24 foreign-owned taxpayers. We continue to build a catalogue of base erosion and profit shifting structures and arrangements (i.e. BEPS typologies) used by multinationals. At present there are 11 broad BEPS typologies and we use these in conjunction with other profit shifting risk models to detect international risks and ensure that an adequate level of investigation is undertaken.
- 49 For lower- and medium-risk taxpayers (lower consequence) we run macro and micro level analysis to detect trends against economic performance and individual taxpayer performance, both over time and against industry performance. We select approximately 350 taxpayers for review based on this analysis combined with our knowledge of significant transactions and their relationship with us. We then select a smaller number of these taxpayers to be assured in more detail by conducting audits (on average 50 to 70 taxpayers per year).

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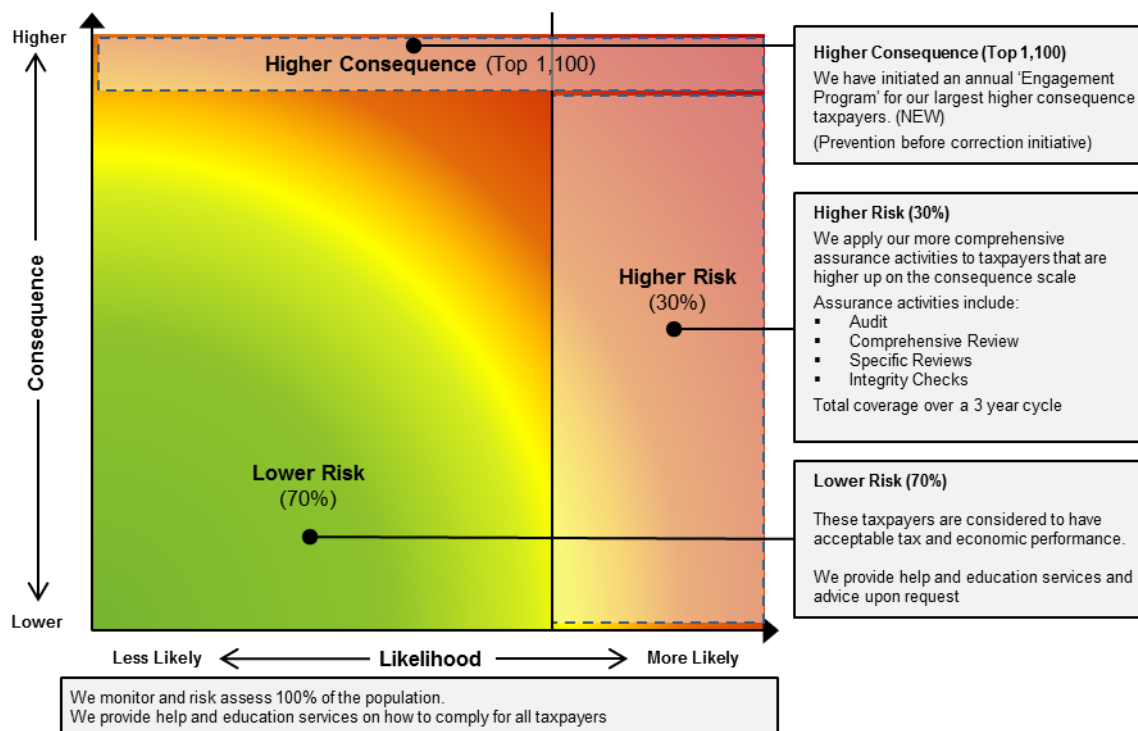
- 50 We assure that the correct income is returned using data analytics and a mixture of ‘one-to-one’ and ‘one-to-many’ leveraged approaches. Our strategy is to influence taxpayers pre-lodgment and to target certain segments of the lower consequence population through guidance, alerts and workshops. One-to-one approaches for lower consequence taxpayers include our Private Binding Ruling and APA programs. A leveraged or tailored approach example is the “light-touch” service and assurance offering to support restructuring businesses. This project-based approach is proving successful. Examples of one-to-many leveraged approaches include Taxpayer Alerts and Guidance (e.g. an alert issued for property developers recently, new public guidance concerning Division 7A). We also undertake post-lodgment review and audit activities as required.

Private companies

- 51 For private companies we use internal and external data sources to establish links between entities and individuals to better understand the behaviour of the controlling mind behind a private group structure. Our risk assessment and strategic approaches are subsequently targeted at the group level and we are changing our assurance approaches to ‘prevention before correction’ through increased early engagement and transparency initiatives.
- 52 Our RDF provides an initial risk assessment that informs our assurance strategies. The size and diversity of the private groups requires a risk tolerance approach and we categorise taxpayers into either lower or higher risk categories based on their propensity for non-compliance and our view of an acceptable risk level. Higher risk does not mean that we think the taxpayer is non-compliant, but rather that there is a higher propensity for non-compliance based on known characteristics (including historical tax performance) and attributes of a particular wealth group.
- 53 The level of our resource investment is also informed by the potential impact on the revenue system i.e. consequence of potential non-compliance. Higher consequence taxpayers are likely to be subject to increased scrutiny and more comprehensive and resource intensive assurance activities. Our more complex audits are often associated with High Wealth Individuals.

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Figure 5: Private groups RDF model



- 54 Our RDF runs risk models over 100% of the population and is further enhanced through intelligence from taxpayer interactions and other sources. Based on this monitoring, our assurance activities include:
- We provide help and education services for all taxpayers on how to comply with tax obligations.
 - For our largest higher consequence taxpayers (top 1,100) we have a program of annual engagement that will assure \$4.7 billion of revenue equating to 21% of the \$22 billion corporate tax paid by private companies.
 - Approximately 30% of the population attracts our attention (i.e. higher risk – this doesn't assert non-compliance but that we have some concern). Our program aims to engage with these taxpayers over a three year cycle to assure compliance. Our 24,000¹¹ activities per annum include integrity checks, risk reviews, audits and provides assurance over \$5.8 billion of revenue equating to 26% of the \$22 billion corporate tax paid by private companies. We apply our more comprehensive assurance activities to taxpayers who are higher up on the consequence scale. As a

¹¹ This includes companies with a turnover of <\$2 million.

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result our audit program has a strong focus on High Wealth Individuals by virtue of their size, influence and group complexity.

- Those of lower risk (70%) are considered to have acceptable tax and economic performance and no significant risks identified. Other than through the provision of help and education they are not actively engaged unless their tax performance changes or a significant risk is identified.

OUR WORK PROGRAM

- 55 Traditionally our compliance focus commenced with an analysis of income tax return data, leading to risk reviews and audits where a risk was identified. This was supplemented by some service offerings. Over the past two years we have increased our service focus to a more balanced mix of pre- and post- lodgment activities. Pre lodgment activities include Private Binding Rulings, Advance Pricing Agreements (APAs), Annual Compliance Arrangements (ACAs), and Pre-lodgment Compliance Reviews (PCRs). Post-lodgment activities include a range of reviews and audits, including annual compliance reviews of APAs. Our increasing focus on a *prevention before correction* approach aims to identify and address risks pre-lodgment.¹²
- 56 We currently offer a range of opportunities allowing corporate taxpayers to be transparent and disclose significant (or potentially contentious) corporate tax planning and major transactions to the ATO. The reportable tax position schedule for income tax is an example, and applies to our largest corporate taxpayers. Using this schedule, our largest companies must disclose their most contestable and material tax positions. This supports a more contemporaneous review of, and engagement with these taxpayers, supporting increased taxpayer transparency in a targeted and efficient manner.
- 57 We look for ways to improve our work program. In 2012 a review of the rulings process was undertaken with the aim of reducing cycle times while improving the overall process for larger taxpayers. As a result an “early engagement” process was developed in consultation with key advisory firms and taxpayers and implemented in 2013. This has resulted in greater certainty for taxpayers on how the ATO may view

¹² Full descriptions of these services or products can be found in the glossary.

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particular transactions or tax positions much earlier in their formulation and has been broadened beyond larger taxpayers. The new process provides the ATO with an increased level of confidence that future revenues have been assured as well as important intelligence about current trends. We are revisiting the way in which we undertake auditing and investigatory work, including shortening our audit cycle to an 18 month benchmark. We are also simplifying interactions and reducing costs of compliance via the External Compliance Assurance Program (ECAP) pilot which is testing the use of external financial auditors to test factual matters.

- 58 We conduct reviews to understand risk and also undertake audit work in relation to taxpayers where we consider there is a higher likelihood of non-compliance with tax obligations. Where corporates choose not to work with the ATO we use our access and related powers to investigate potential or suspected non-compliance.
- 59 As part of our compliance program, for 2012-13 we assured 74.8% of the Public Groups and International (PGI) company corporate tax base (i.e. \$44.8 billion of the \$66.9 billion total tax paid) through our various engagements with taxpayers. For the same period, we assured 26.5% of the Private Groups and High Wealth Individuals (PGH) company corporate tax base (i.e. \$22 billion of the \$66.9 billion total tax paid¹³) with more than 24,000 activities undertaken in this year. For the same period we assured or are assuring 60% of all cross border related party dealings through various compliance activities.

Identified tax risks and our treatment strategies

- 60 Based on our work (data analysis, economic trends and compliance assurance activities), our assessment is that most taxpayers comply with the law. The following paragraphs outline some of the major risks we have identified as well as the compliance strategies deployed to address these.
- 61 We focus on risks that are of greater consequence to Australia's revenue base and to the integrity of the tax system. From an ATO perspective over the past four years the nature of the risks in the corporate marketplace has remained relatively unchanged, with one exception - the growing base erosion and profit shifting risk.

¹³ This includes private companies with a turnover less than \$2million.

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- 62 We address a number of ongoing systemic risks such as capital gains tax, consolidations, losses and international issues (including transfer pricing and offshore evasion). We also ensure that our focus aligns with economic trends. Presently we are looking closely at the banking and finance and energy and resources industries as well as the growing area of infrastructure investment and international offshore avoidance and evasion.

International risks

- 63 Globalisation and the expansion of e-commerce have resulted in increasing cross-border trade and our focus is to ensure that Australia receives its share of tax under the current international tax rules.
- 64 Profit shifting in large and medium-sized multinational entities and private groups presents complex and sometimes costly challenges for the ATO. For example, in one case the audit and dispute have continued for around 6 years. When this case came before the courts, the multinational taxpayer invested very heavily in defending their position, with 12 expert opinions. Whilst the ATO has a robust multi-disciplinary capability to tackle profit shifting, including auditors, economists and lawyers, wealthy corporates will increasingly challenge our capability. Notwithstanding this risk, the ATO will work closely with other jurisdictions, international bodies like the OECD and Government to enhance the level playing field in the international tax system.
- 65 The risks we are seeing include:
- transfer mis-pricing (i.e. non-arm's length pricing of related party dealings – transfer pricing is not an exact science which often leads to differing views, particularly about valuations and benchmarking involving comparability)
 - thin capitalisation (using valuations, and other complex mechanisms to fund Australian operations using excessive debt). This results in additional tax deductions for interest payments eroding the Australian corporate tax base
 - international restructures of multinational enterprises, adopting global supply chains, with profit shifting consequences
 - complex financing arrangements, sometimes employing hybrid structures or instruments, that result in 'stateless' or untaxed income, and

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- digital business platforms that have a large economic presence in a jurisdiction relative to their tax contributions

66 Profit shifting risk models are run across public, private and foreign-owned taxpayer populations and cover 100% of all cross border related party dealings. This allows us to focus resources on the higher risk and higher consequence taxpayers to mitigate international and profit shifting risks. Cross-border arrangements are monitored through the compliance, APA and rulings programs. This allows the ATO to detect emerging risk through the identification of new profit shifting structures adopted by multinationals and incorporate this into our international risk identification process.

67 More than 70% of risks currently being addressed in public groups and foreign-owned corporates are international. Our four-year International Structuring and Profit Shifting (ISAPS) compliance program is focusing on a large number of companies that have undertaken international restructures or have significant cross-border arrangements. The program is now in its second year and entails reviewing structures and arrangements to determine if they represent a contestable shifting of profits outside Australia. This enhanced audit programme will ensure compliance with renewed laws dealing with transfer pricing and thin capitalisation.

68 Where we investigate international risks we apply a whole of tax code approach. This ensures that any domestic tax risks, eg CGT risks, consolidation risks etc, are fully considered as part of our compliance activities.

69 International and profit shifting risks are being mitigated through a range of activities:

- Differentiated compliance approaches are being used for profit shifting risk. This includes using risk reviews and audits on our larger taxpayers and those who exhibit higher levels of risk. Leveraged approaches are also used to mitigate risk among our smaller taxpayers and those that exhibit lower levels of risk (eg project work).
- Marketing and communications activities provide guidance on the operation of the law to promote voluntary compliance and deter non-compliance. This includes determining an ATO view on some aspects of the income tax legislation.

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- Intelligence from cases with international issues, other external sources and other jurisdictions is being gathered to identify and analyse new, emerging and evolving profit-shifting trends. The ATO is leading a number of cross-jurisdictional multi-lateral initiatives targeted at specific international tax risks, for example, e-commerce and the ICIJ¹⁴ Luxembourg leaked tax clearances.
- Where we identify that current domestic tax laws are not effective or are achieving unintended policy outcomes, we will provide relevant empirical evidence to government and the Treasury to consider the need for law reform. Recent examples include: the change to transfer pricing provisions in Division 815; new rules limiting the extent to which companies can shift profits out of Australia through excessively debt funding their Australian operations (the safe harbour debt limit has been reduced from 75% to 60%). We are building on Australia's relatively strong international tax framework including treaties, attribution rules (for controlled foreign companies), transfer pricing, thin capitalisation and the general anti-avoidance rule.

Offshore evasion

- 70 Offshore tax evasion often involves the use of complex structures and secrecy jurisdictions to conceal assets and income. These are being detected and tackled using a variety of approaches, most importantly, domestic and international cross-agency collaboration and international transparency. Over the last few years more than 30 Tax Exchange of Information Agreements have been signed with non-treaty countries, significantly reducing the number of financial secrecy jurisdictions. An example of cross-agency collaboration in this respect is Project Wickenby.

Structuring risks

- 71 Increasing globalisation, the continuing growth of e-commerce and the enhanced capabilities of large multinational corporates 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. In our compliance program we are targeting international, as well as domestic structuring risks.

¹⁴ International Consortium of Investigative Journalists.

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- 72 Domestically, structuring events are a natural part of Australia's open economy and business operations. They include mergers and acquisitions, divestment of major assets and demergers, share buybacks, capital raisings and returns of capital, private equity entries and exits, initial public offerings, and cessation of business in Australia. Tax concerns arise when these events are structured to achieve more than the business outcome. The risks we see include:
- Consolidation – issues when businesses restructure or undertake a merger or acquisition. Of particular concern is the incorrect or contrived application of the consolidation cost-setting rules when an entity joins or leaves a group. This can lead to incorrect or unintended uplifts in the tax cost of assets.
 - Taxation of Financial Arrangements (TOFA) – unnecessary and contrived steps in financial arrangements.
 - Capital gains tax – businesses engage in complex restructuring that attempts to disguise asset sales or manipulate asset valuations to artificially avoid or reduce their capital gains tax (CGT) liabilities. Some businesses attempt to reclassify revenue and capital items so they can inappropriately access concessional tax treatments. Others simply fail to disclose CGT events or restructure to attempt to access small business concessions when they are not eligible.
 - Infrastructure investment - has been increasing, particularly through development of Australia's natural resources, government initiatives and the sale of government-owned entities. Privatisation and infrastructure investments give rise to a number of tax issues, spanning financing tax risks, tax deductibility of certain expenditure, CGT on sales of capital assets, and capital allowances for depreciable assets.

INAPPROPRIATE PROFIT EXTRACTION RISKS

- 73 We continue to see privately owned corporate groups, often controlled by a wealthy individual or family, designing complex business structures (including discretionary trusts) to extract company profits without payment of appropriate tax. This includes shareholders and their associates accessing company profits for personal expenses or using business lifestyle assets for private purposes. Discretionary trusts are often used in conjunction with corporate structures. While the majority of taxpayers are using trust structures appropriately, discretionary trusts provide flexibility in income

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distribution and some taxpayers attempt to avoid appropriate tax outcomes by deliberately misrepresenting or concealing income and activity.

- 74 In addition we see Phoenix behaviour whereby tax obligations are not met by deliberately taking companies into liquidation and continuing to operate through other business structures. We are working to eliminate the opportunity and reduce the motivation for businesses (and individuals) to engage in, facilitate or promote fraudulent phoenix activity, through a range of strategies including:
- community participation and engagement
 - direct contact with potential phoenix operators
 - active compliance activities (reviews, audits and default assessments)
 - cross agency activities such as working with the Australian Federal Police Criminal Assets Confiscation Taskforce and ASIC to identify assets acquired by fraudulent phoenix operators for potential seizure to satisfy unpaid tax and super guarantee debts, and
 - consultation with peak industry participants (i.e. large corporates).

Losses

- 75 We are mindful of the impact of the global financial crisis on taxpayers. The total pool of tax losses carried forward for all companies was \$264.8 billion in 2012-13, representing 80% of the total tax losses pool, with over 60% of that value held by public companies. Over the last five years, losses utilised by companies has averaged less than 9% of the pool given that utilisation relies on satisfaction of statutory tests, the availability of taxable income and other controls in the system. In 2012-13, 148,738 companies utilised \$18.1 billion of prior year losses against current year taxable income. Successive legislative changes and government funding for losses compliance work over many years has led to a reduction in the number of audit loss adjustments, with current activity limited to highest loss claimants to ensure correct loss recoupment. Our current strategy largely focuses on deterrence, including assisting taxpayers to understand their obligations and making it easier for them to comply.

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DISPUTE RESOLUTION

- 76 We acknowledge that disputes will arise between the ATO and corporates on the application of the tax law. The ATO is using alternative dispute resolution techniques with the objective of achieving timely and cost effective outcomes. Our independent review service for all large market audit positions is providing an important avenue for the independent assessment of ATO views on audit issues. We note that dispute resolution is the subject of a separate Tax Disputes Inquiry by the House of Representatives Standing Committee on Tax and Revenue.

SECTION 4 – OUR CAPABILITY

Approximately 2,700 ATO staff work in compliance areas with a primary focus on foreign-owned, publicly-listed and privately-owned corporates and their related individual business owners. Around 2,100 of those staff work directly on assurance activities like audits, reviews and investigations, with more than 450 providing advice.

We continuously build core capabilities to ensure we carry out our role effectively. In particular we:

- recruit external specialists to supplement and build our knowledge;
- have targeted training programs to develop our staff including a current focus on building our investigative capability in international tax compliance;
- use consultation and scrutiny reviews to adapt and refine our processes and approaches;
- have improved our audit and review processes including information gathering and case selection to improve both our effectiveness and efficiency;
- are continuously improving our technology platforms to provide our staff with timely, innovative and seamless access to information.

HOW WE ARE STRUCTURED

77 Income tax issues for corporates are managed through two main business lines within the ATO. Broadly, the Public Groups and International (PG&I) business line has responsibility for all publicly-listed and international entities and the Private Groups and High Wealth Individuals (PGH) business line has responsibility for private groups (with turnover greater than \$2 million). This includes wealthy individuals who control net wealth greater than \$5 million and their associated businesses. Each area is led by a Deputy Commissioner and in some instances supplemented with specialised Deputy Commissioner level leadership around Case Leadership, Aggressive Tax Planning and International issues.

78 The majority of our staff in these areas are degree qualified or above, with the most prevalent disciplines being Accountancy, Business, Law and Economics. We also

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have teams providing specific services including a specialist economist group, and an audit and accounting specialist group.

- 79 Active compliance will always remain an important part of our corporate compliance strategy. Around 2700 ATO officers are engaged in work with corporates. Over the past few years we have concentrated on providing a more contemporary service whilst working to resolve any potential tax issues prior to final lodgment.
- 80 While our recent redundancy program reduced our staff numbers we have retained high levels of experience and expertise and continue working to develop critical expertise in our staff. This includes recruitment of an additional 80 audit, accounting and tax law specialists and ensuring succession plans are in place for senior ATO roles. 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.
- 81 A deliberate effort was made to reduce positions not dealing directly with taxpayers and to provide effective knowledge handover. Due to a significant focus on improving and streamlining internal processes we have ensured that the ability to carry out our role as an assurer of the corporate tax base has not been compromised.

Public Groups and International

- 82 There are 1,135 staff working on issues associated with Public Groups and International (PG&I). Of this number, 795 staff work directly on assurance, audit and enforcement work and 95 work on risk identification and risk management. Another 145 staff provide rulings and advice. 585 staff are at the executive level and 30 at the senior executive level. Most staff dealing with large businesses have in excess of 15 years ATO tenure with a balanced mix of public and private sector experience at senior leadership levels. Of the numbers above, the international area comprises 153 (up from 130 in 2011-12) and includes 75 executive and 11 senior executive level staff. Many of these staff have in excess of 10 years tax experience in business/advisory roles.

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- 83 Since June 2012 the ATO has focused on building international tax skills through closer integration of various teams including transfer pricing, economist and tax law specialists. This recognises the variety of skills required to holistically assess a multinational company. A number of support systems to systematically capture and disseminate international knowledge have also been implemented.
- 84 A comprehensive training and mentoring program has been developed, including an internationals master class and intensive profit shifting training. The program has been delivered to staff by senior specialists or University of Sydney professors. Topics include transfer pricing, thin capitalisation, and the global business environment, amongst many others. All staff in Public Groups and International undertake significant amounts of training on tax technical and other topics, representing an investment in 2013-14 of \$220,000 on courses external to the ATO, and over 30,000 hours of staff time on internal courses.

Private Groups and High Wealth Individuals

- 85 This business line has 1,528 staff (including Project Wickenby staff) focusing on managing the compliance of private groups, wealthy individuals and associated entities. Of this number, approximately 1,012 work on compliance assurance and enforcement with a further 151 staff working in risk identification and management, strategy development, data management, and analytics. 180 staff work on determining objections, and providing rulings and advice.

KEY CAPABILITY INITIATIVES

- 86 We are changing our approaches through the Reinventing the ATO program. While we are confident in our current capability we are also focused on meeting any future challenges. In 2014 we commissioned an independent study to advise on the specific capabilities required in Public Groups and International. The review consulted key APS stakeholders, taxpayers, advisory firms and professional and industry bodies and identified a number of priority activities. These are being implemented, including an expert series focusing on commercial awareness, business drivers and the different external perspectives of industry.

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- 87 We are improving our internal processes ensuring that we maximise the effectiveness and efficiency of our efforts. For example, our systems case management support for staff is being streamlined, and duplication and overly-prescriptive processes are being removed. We are improving the accuracy of our case selection, meaning that interventions in taxpayers' affairs are more targeted. We have introduced procedures to support an 18 month large business audit cycle time (from two years currently) and the average time taken to complete a large taxpayer audit has reduced from 765 to 740 days in the two years to 30 June 2014, with risk reviews completed on average in around 250 days. Completion times are expected to further reduce with the finalisation of numbers of older cases.
- 88 The Independent Review and Dispute Resolution business line requires an officer independent of the audit function to have a 'fresh look' at the contentions raised by the taxpayer and the position put by the audit team in the statement of audit position. The independent review process has provided us with an opportunity to build capability within our compliance teams via focused feedback to our auditors. This is helping our audit case teams modify their approaches to better reflect contemporary business practices and provides earlier certainty to corporates regarding their tax obligations.
- 89 In early 2014 we recruited an additional 80 specialists, mainly from the private sector, in the areas of audit, tax accounting and tax law. As well as contributing directly through our International Structuring and Profit Shifting (ISAPS) program, these staff were recruited to train and mentor staff and to ensure we adopt contemporary business practices. The new ideas and practices these specialists have brought to the ATO are proving invaluable. This includes greater integration of ASIC financial data into our risk identification processes.
- 90 Our Financial Reporting and Analysis (FRA) project is exploring the potential benefits of regularly obtaining accounting data from taxpayers to better understand their business and to detect potential compliance risks. This will reduce the compliance burden on taxpayers through using their natural business systems data and will provide the ATO with more detailed data than is currently available in returns and schedules. We will be testing the use of a range of automated analytical techniques

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along with accounting ratio analysis to detect risks associated with both specific taxpayers and taxpayer groups (such as industries).

SECTION 5 – CORPORATE INCOME TAX PERFORMANCE

A suite of indicators generally suggests 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.

The large business contribution to overall company income tax receipts has increased since 2010-11. Large business contributed around 64.6% of total company income tax receipts in 2013-14, compared with 62.5% in 2010-11.

Our shift towards early engagement has seen a reduction in the number of audit and review cases in the current year. Revenue from these cases has remained relatively consistent over the last decade notwithstanding the growth in tax collections, again indicating the correct amount of tax is being paid.

- 91 We use a range of indicators at the macro (aggregate performance of companies compared to economic trends) and micro (individual taxpayer performance) level to determine whether companies are paying the right amount of tax.
- 92 At the macroeconomic level tax revenue receipts have steadily increased since 2010-11 by approximately 2%. Despite the low levels of growth, since 2010-11 company income tax collections have increased at a faster rate than corporate gross operating surplus (GOS). The observed and continuing trend¹⁵ reflects that a broadly consistent level of income tax is being paid relative to corporate profit over time and that the growth in receipts is appropriate given the level of net profit realised by these public groups.

¹⁵ Inclusive of 2013 income tax returns.

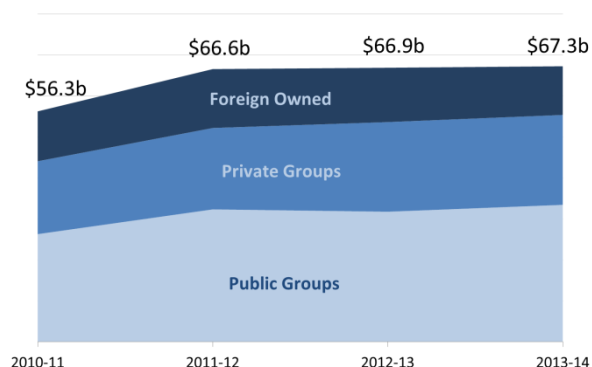
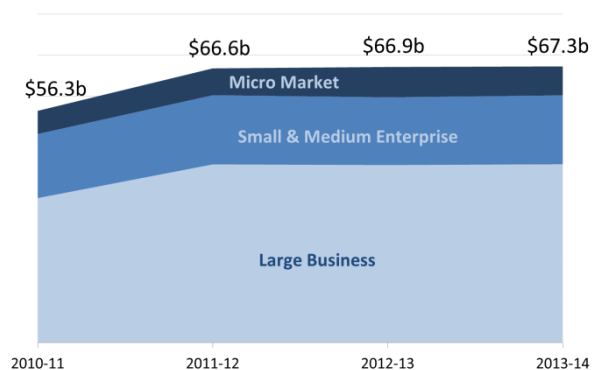
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- 93 At the micro level we assure ourselves that companies are meeting their obligations (register, lodge, report and pay) and that risks to the system are detected. Most companies meet their obligations. This is particularly true for the large market.

CORPORATE INCOME TAX REVENUE

- 94 Corporate income tax receipts increased from \$56.3b to \$67.3b (19.6%) over the three years to 2013-14, despite slower growth in the 2012-13 and 2013-14 years.
- 95 The figures below show corporate tax receipts by *market segment*¹⁶ and by *group ownership* respectively:

Figure 6: Corporate tax receipts



- 96 The large business contribution to overall company income tax receipts has increased since 2010-11. Large business contributed around 64.6% of total company income tax

¹⁶ Market segments defined as: large market (annual group turnover > \$250 million), small and medium enterprise (annual group turnover between \$2 million - \$250 million), micro market (annual group turnover < \$2 million).

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receipts in 2013-14, compared with 62.6% in 2010-11. During the same period, the contribution from micro enterprises also increased from 10% to 10.5%, while the contribution from small to medium business decreased from 27.7% to 24.9%.

REVENUE PERFORMANCE MEASURES

97 We use a range of revenue performance measures to help us understand if the aggregate corporate income tax paid aligns with economic performance indicators. Three of these macro-economic measures of the health of the system include:

- Corporate *Gross Operating Surplus* (GOS) *(all companies)*
- Reported net profits *(public groups only)*
- Tax gap analysis *(all companies)*

Corporate *Gross Operating Surplus* (GOS)

98 Corporate GOS¹⁷ (used as a proxy for corporate profitability) is one measure which may be used to indicate the performance of corporate income tax receipts over time. More specifically, it helps us to determine if corporate income tax revenue is appropriate on an aggregate level.

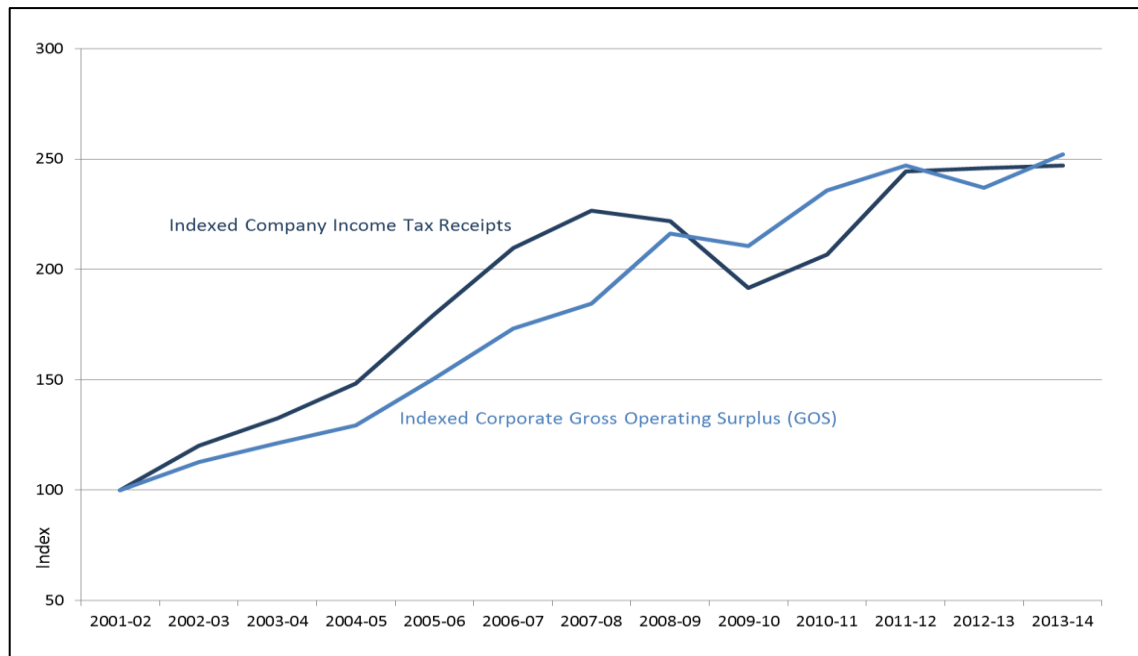
99 In recent years, growth in corporate GOS has been relatively stagnant and this is a trend which has been reflected in the low growth profile of corporate income tax receipts during this period. Despite the low levels of growth, since 2010-11 company income tax collections have increased at a faster rate than corporate GOS.

100 The figure below illustrates the long term correlation between corporate income tax receipts and corporate GOS. It demonstrates that corporate income tax receipts have largely kept pace with corporate GOS over this extended period:

¹⁷ Gross Operating Surplus (GOS) is derived as the excess of gross output, over the costs incurred in producing that output, before allowing for consumption of fixed capital (Australian Bureau of Statistics).

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Figure 7: Corporate income tax receipts and corporate GOS



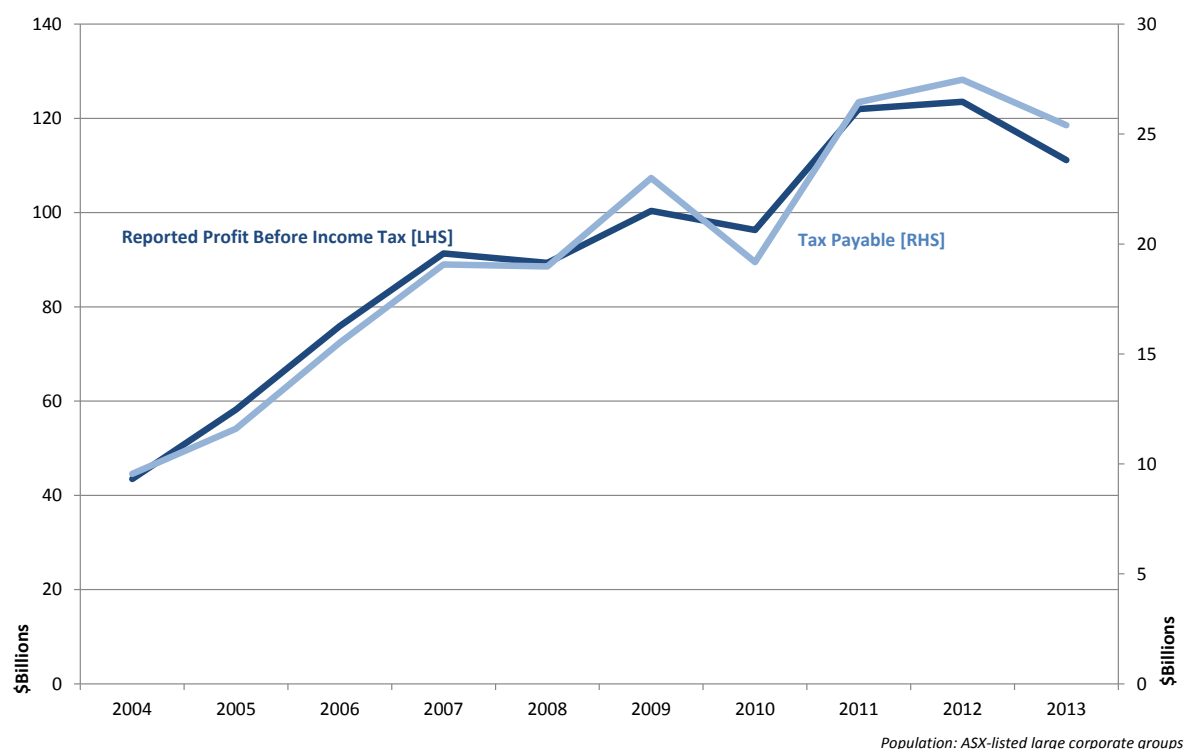
Reported net profits (public groups¹⁸ only)

- 101 Public groups comprise a small percentage of the corporate population; however these businesses include some of the largest in Australia and collectively account for almost half of total company income tax receipts. All ASX-listed companies report comprehensive financial information to ASIC and the ASX.
- 102 Our data matching analysis of net profits (sourced from company financial reports) and tax payable (sourced from company income tax returns) has established that there is an observable long-term correlation between these measures. The observed and continuing trend¹⁹ reflects a broadly consistent level of income tax being paid relative to corporate profit over time and that the growth in receipts is appropriate given the level of net profit realised by these public groups.

¹⁸ ASX-listed groups only.

¹⁹ Data is inclusive of 2013 income tax returns and consists of ASX listed companies on a matched basis to their respective Company Income Tax Return(s).

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Figure 8: Trends in net profit and tax payable

103 Due to limited availability of net profit data (other than income tax return data) for foreign-owned and private groups, this type of analysis is not able to be produced for corporates other than public groups at this stage. It is anticipated that with the introduction of country-by-country reporting, more comprehensive financial data may aid future analysis of private and foreign-owned groups in Australia.

Tax gap analysis

104 To assure compliance, some countries use a tax gap analysis. The ATO has tax gap analysis in place for GST and is currently exploring using tax gap analysis as another method to help us assure income tax compliance. The ATO tax gap analysis for large corporates is expected to be completed in late 2015.

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COMPLIANCE PERFORMANCE MEASURES

Assurance

- 105 More than 74% of corporate entities lodged their income tax return and business activity statements on time with more than 86% paying their income tax liability on time. For large businesses, 95.1% of large businesses paid their tax on time, with 98.4% paying within 90 days of the due date.
- 106 We undertake a wide range of activities to assure that taxpayers are complying with the law. These activities take place before lodgment – ACAs and PCRs, and post lodgment – reviews and audits. Some 59% of the corporate tax base (of total tax paid) is covered by assurance activities.
- 107 Our confidence that companies are complying is further supported by the increase in companies coming to us for early engagement and ruling requests.

Table 5: Large business early engagement product completions by year

| | 2010/11 | 2011/12 | 2012/13 | 2013/14 |
|------------------------|---------|---------|---------|---------|
| Private rulings | 276 | 254 | 270 | 303 |
| Class rulings | 71 | 55 | 49 | 60 |
| Guidance | 163 | 216 | 219 | 245 |

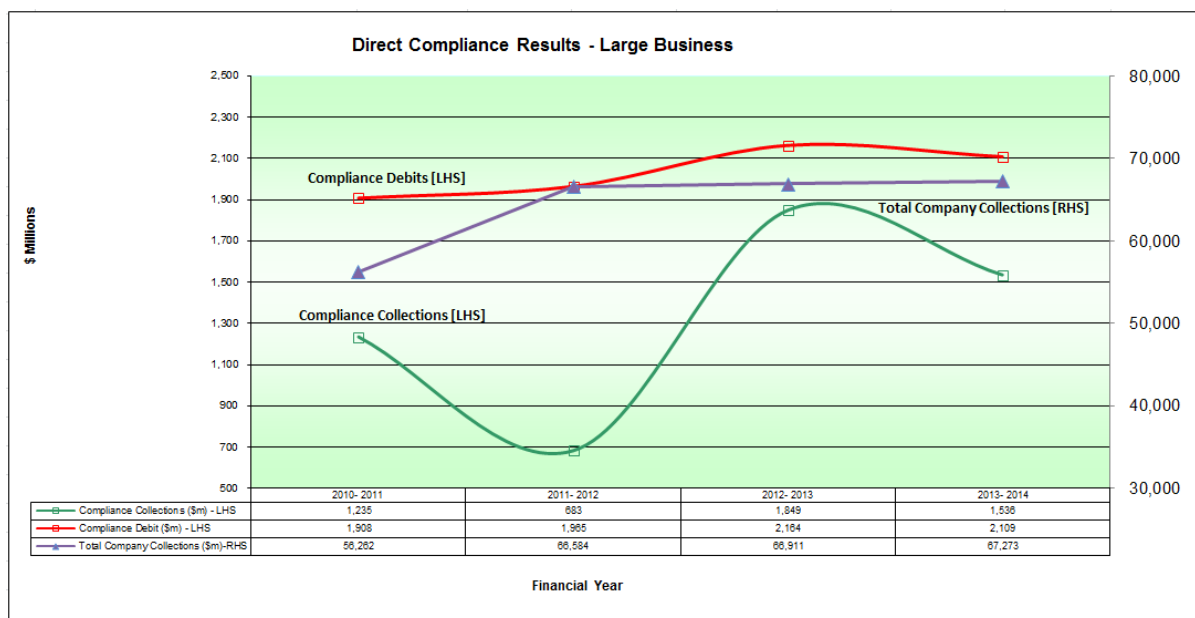
- 108 The early engagement process has produced a number of key benefits including:
- earlier and improved certainty of tax positions by working with taxpayers in preparing their formal request for advice
 - early warning of potentially emerging risks and the changing nature of issues shaping the tax system environment
 - better alignment of technical experts with the focus of having the right people doing the right work at the right time.
- 109 As a result of our assurance activities we identify taxpayers who are not complying with the law and make adjustments to their tax liability. Over the past 4 years the adjustment level for corporates has been less than 5% of total tax paid. Our adjustments are measured as audit yield.

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Audit yield

110 Audit yield for large businesses in terms of liabilities raised and cash collected has remained relatively consistent as shown in the ‘Direct compliance results’ chart below. Collections have averaged approximately \$1.3 billion while liabilities raised have averaged approximately \$2.0 billion²⁰. There was a reduction in collections in 2011 due to the downstream impacts of the GFC. Collection and debit results for the current financial year are projected to be slightly above averages for the last four years.

Figure 9: Direct compliance results for large business



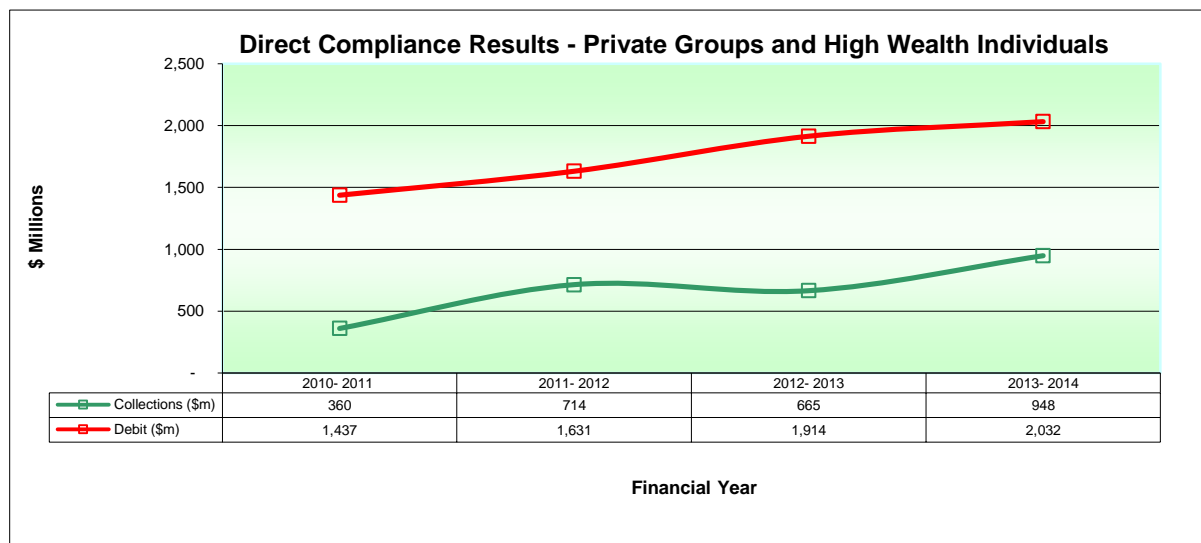
111 We adopt a group approach when monitoring the compliance of Private Groups and Wealthy Individuals. Over the last four years we have raised over \$8 billion in liabilities and collected over \$3 billion in cash. The chart below shows this trend over time²¹. Of the liabilities raised in this period:

- More than \$1.1 billion was raised through Project Wickenby
- Approximately \$3.8 billion relates to liabilities raised across the HWI population.

²⁰Liabilities have been higher than cash collections as a proportion of liabilities raised. This is because large audit results in dispute take time to resolve through court processes.

²¹ The data reflects audit yield for private groups which may include multiple entities such as companies, trusts and partnerships. As such the results may be overestimated where a comparable company only result is required.

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Figure 10: Direct compliance results for private groups

112 In the 2013-14 year, we undertook 71 audits and 275 risk reviews for large public companies, and 5300 compliance activities for private groups.²²

Penalty analysis

113 The vast majority of corporates do not exhibit aggressive tax planning behaviours and the level of penalty directly correlates to the culpability or compliance stance of the taxpayer. The higher the level the greater the culpability, defined as 'reasonable care', 'recklessness' or 'fraud or evasion'. For an analysis of the levels of penalties imposed over the 2012 to 2014 years (see chart below²³) we observe:

- Over 60% of public companies adjusted cases had a 0% penalty indicating a voluntary disclosure or reasonably arguable position compared to 40% of private company cases;
- Application of the 25% penalty indicating reasonable care was similar for both public groups and private companies;
- Application of the 50% penalty indicating recklessness, while rarely applied, was applied almost three times as often with private company cases, and
- In respect of the 75% penalty indicating fraud or evasion, again rarely applied, this was applied almost four times more often to private companies (noting that this

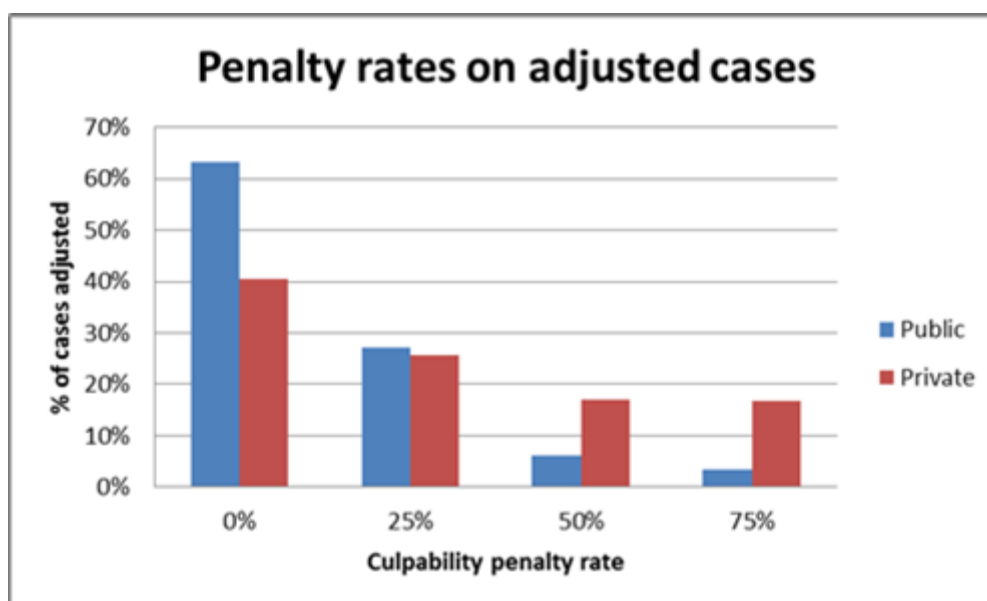
²² Private groups include other entities in addition to corporates, e.g. trusts, partnerships and individuals.

²³ The graph includes cases subject to objection where the culpability penalty may have subsequently been remitted in full or part. It does however reflect outcomes of settlements.

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includes Project Wickenby cases). This is a reflection of the more egregious tax planning found in respect of private companies compared to public companies where adjustments are more commonly in respect of different interpretations of the law.

Figure 11: Penalty rates on adjusted cases for 2012 - 2014



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GLOSSARY

| | |
|-------------------------------------|--|
| Annual Compliance Arrangement (ACA) | The ACA is an administrative arrangement developed to manage the compliance relationship with a large taxpayer in an open and transparent environment. |
| Advance Pricing Arrangement (APA) | An arrangement with the ATO which allows for an agreed future application of the arm's length principle to a taxpayer's dealings with international related parties. APAs may be unilateral which involves a taxpayer in Australia and the ATO, or bilateral or multilateral which involves an agreement between two or more tax administrations and their respective taxpayers. |
| Audit | An intensive case examination where material underpayment of income tax, GST or excise is a risk. |
| Audit yield | As a result of its assurance activities, the ATO identifies taxpayers who are not complying with the law and makes adjustments to their tax liability. Such adjustments are measured as audit yield. |
| APRA | Australian Prudential Regulation Authority - www.apra.gov.au |
| ASIC | Australian Securities and Investments Commission http://asic.gov.au |
| ASX | Australian Stock Exchange http://www.asx.com.au |
| AUSTRAC | Australian Transaction Reports and Analysis Centre - http://www.austrac.gov.au/ |
| BEPS | Base Erosion and Profit Shifting involves the transfer of profits earned in one jurisdiction to another lower-taxing jurisdiction. |
| Capital Gains Tax (CGT) | A capital gain or capital loss is the difference between what it cost you to get an asset and what you received when you disposed of it. You pay tax on your capital gains. It forms part of your income tax and is not considered a separate tax, although it is generally referred to as capital gains tax (CGT). |
| Client risk review | A broad, case level risk assessment product that normally covers a range of risk focus areas. |
| Class rulings | Provide legally binding advice in response to a request from a taxpayer seeking advice about the application of a tax law to a specific class of people about to enter a |

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| | |
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| | particular arrangement. |
| Common Reporting Standard (CRS) | The Common Reporting Standard for the automatic exchange of tax information is a single global standard for financial institutions' collection of financial account information on account holders who are residents in another jurisdiction, the reporting of it to the financial institutions' tax authority and the exchange of it automatically with other jurisdictions' tax authorities on an annual basis. |
| Company life cycle | The ATO recognises the appetites for tax risk at each of the different stages of the life cycle of a business. |
| Company income tax receipts | amount of tax paid and collected in a given year |
| External Compliance Assurance Process (ECAP) | Taxpayers with turnover above \$100 million using registered company auditors to conduct assurance on factual matters. |
| GST | Goods and Services Tax |
| High Wealth Individuals (HWI) | Australian residents who, together with their associates, control over \$30 million in net assets. |
| International Related Party Dealings (IRPD) | International commercial or financial dealings or relations between two or more related persons. |
| Mutual agreement procedure (MAP) | Mutual agreement procedures seek to provide relief to taxpayers from 'double taxation' arising from the imposition of tax by another jurisdiction. |
| Organisation for Economic Co-operation and Development's (OECD) Base Erosion and Profit Shifting (BEPS) Action Plan | http://www.oecd.org/ctp/beps.htm |
| Pre-lodgment compliance review (PCR) | Used to identify and assess potential tax risks, including reportable tax position (RTP) disclosures as they arise. The PCR product is intended to be used on all higher consequence taxpayers who do not have an Annual Compliance Arrangement (ACA) with the ATO |
| Private rulings | Provide legally binding advice in response to a request from a client seeking advice about the application of a tax law |
| Reportable tax position schedule (RTP) | The reportable tax position schedule (the RTP schedule) is a schedule to the company income tax return that requires large businesses to disclose their most contestable and material tax positions under one or more of the following categories: |

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| | <ul style="list-style-type: none"> • a position that is about as likely to be correct as incorrect, or is less likely to be correct than incorrect • a position where uncertainty about taxes payable or recoverable is recognised or disclosed in the taxpayer's or a related party's financial statements • a reportable transaction or event. |
| Risk-differentiation framework (RDF) | A framework used by the ATO to assess a taxpayer's tax risk and to determine the intensity of the ATO's response in a coherent, consistent and considered way. It complements the ATO's compliance model, which suggests an appropriate choice of remedy. |
| Specific review | Used to review a specific risk identified from a particular event |
| Standard Business Reporting (SBR) | A standard approach to online or digital record keeping introduced by the Australian Government in 2010. SBR incorporates standard terms that are used in government legislation and reporting. These terms are then linked to terms that are in the business/accounting software creating consistency for business and government |
| TOFA | Legislation concerning the Taxation of Financial Arrangements |
| Washup | Payment due from the company that arises when Tax Payable is greater than the sum of PAYG instalments received |
| Wealthy individuals | Australian residents who, together with their associates, control over \$5 million in net assets. |