Australian Government
Australian Taxation Office

Australian Taxation Office Submission

Inquiry into financial and tax practices of for-profit aged care providers

June 2018

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Introduction

1. The Australian Taxation Office (ATO) welcomes the opportunity to contribute to the Senate Economics References Committee's inquiry into for-profit providers of aged care services.

2. This submission addresses the term of reference related to the use of tax avoidance or aggressive tax minimisation strategies by for-profit aged care service providers. Specifically it provides:
   - demographics of the population per income tax returns lodged
   - our approach to the industry
   - key tax compliance risks and issues we see in the industry.

3. While we are aware of the Tax Justice Network's report Tax Avoidance by For-Profit *Aged Care Companies: Profit Shifting on Public Funds*, which names particular entities operating in the industry, the privacy provisions under which we operate mean, generally, we can't provide information about specific taxpayers.

4. We have no evidence to suggest the tax risk appetite of the for-profit aged care services industry differs from other industries. The overwhelming majority of entities in this industry want to comply and our engagements with them are aimed at making compliance as easy as possible.

5. For completeness, we have appended our main submissions to the recently concluded Senate Economics Reference Committee inquiry into Corporate Tax Avoidance, which set out our general perspectives on large corporate groups' tax compliance.

Demographics

6. For-profit aged care providers offer a variety of services. Principal among these is long-term aged care accommodation covering the range of resident dependency levels from independent living units and serviced apartments, such as those found in retirement villages), through to high-care facilities such as nursing homes.

7. Additionally, there is significant government investment in home care services. As the demand for aged care services increases and patient preferences change, it is expected the industry will further shift to providing more in-home and in-community care options.

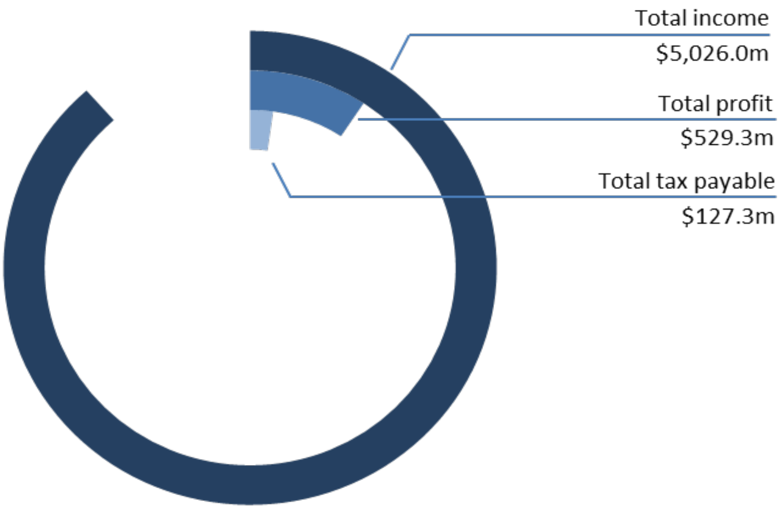
8. The ageing population in Australia is driving growth in this industry. The Australian Bureau of Statistics (ABS) projects the proportion of Australians aged 65 and over to rise to 22 percent, up from 15 percent in 2017.

9. The aged care services industry is made up of many diverse participants with no dominant providers. There are large entities in this industry, but their size reflects the diversity of operations and their aged care operations are generally a small fraction of their overall business activities in Australia. This makes extracting or aggregating industry level financial and taxation information difficult.

Number of reporting entities by ownership type

Ownership	No. of entities[1]
Australian privately owned	1,084
Australian public	45
Foreign owned	18
Total	1,147

Income tax: total income, profits and tax payable of for-profit providers 2015-16[2]



[1] Based on count of reporting entities who have reported, on their income tax return, under ANZSIC code 86011 Accommodation for the aged – where nursing or medical care is provided as a major service, 86012 Accommodation for the aged – where nursing or medical care is not provided as a major service and 87900 Aged care assistance service.

[2] Source: income tax returns for entities reporting under ANZSIC code 86011 Accommodation for the aged – where nursing or medical care is provided as a major service, 86012 Accommodation for the aged – where nursing or medical care is not provided as a major service and 87900 Aged care assistance service.

Our approach to the aged care services industry

10. Nothing in our engagement with entities in the for-profit aged care services industry suggests their tax risk appetite is different from other sectors of the economy. The overwhelming majority want to comply and our engagements with them are aimed at making compliance as easy as possible.

11. Increasingly, our approach to tax compliance is to proactively inform taxpayers of areas of concern as we become aware of them; preventing other taxpayers making mistakes or entering into tax avoidance schemes is a key element of our strategies. We are also focusing on providing relevant and timely public advice and guidance to taxpayers to help them understand their compliance obligations.

12. We use practical compliance guidelines (PCGs) to set out our view of what is concerning and what isn't, from a compliance perspective, particularly in grey areas like transfer pricing. We also continue to issue public rulings to provide our interpretation of legal provisions.

13. Our experience shows that most entities don't consciously take on tax risk. The underlying intent of our public advice and guidance is to prevent these entities from inadvertently finding themselves in a tax dispute because they didn't know our position. Clearly articulating our concerns with arrangements or view of the law allows them to make more informed compliance choices. For the small number of entities that do choose to enter arrangements we have concerns with, we take robust compliance action.

One-to-one engagement

14. We have several programs of one-to-one engagement with the largest and most significant taxpayers who are either public groups, foreign owned groups or under the control of our wealthiest Australians.

15. For public groups and multinational businesses, we have two main one-to-one programs, applying the justified trust approach; the Top 100 program for the very largest companies, and the Top 1000 program for the next largest.

16. For private groups, our main one-to-one program is the Top 320 program, designed to help us gain justified trust the wealthiest private groups are complying with their tax obligations.

17. A number of for-profit aged care providers are subject to assurance activities under our Top 100 or Top 1000 programs. Others are subject to intensive engagement under our Top 320 program. Where we identify areas of concern or risks of non-compliance through these programs, we are taking action to resolve them, including conducting audits and issuing amended assessments.

18. For those for-profit aged care providers who are not within the Top 1000 or Top 320 populations, we apply our risk identification processes to identify taxpayers for review. We apply risk screening based on known issues, such as:

    - timing of income and deductions
    - losses
    - capital gains tax
    - use of wealth extraction techniques for private groups
    - apportionment methodologies and related party dealings for GST issues.

19. Our risk identification uses data analytics and intelligence to ensure we identify and engage with those entities who present the highest risk of non-compliance.

Compliance program status

20. In the last three years, we have conducted or are conducting income tax compliance activities or engagements with:

    - 15 of the largest privately owned providers of for-profit aged care services
    - 11 public or multinational enterprises providing for-profit aged care services.

Key risks and issues

Income tax

Financing arrangements

21. As with other capital intensive industries, we have some concerns over the financing arrangements used by certain multinational entities in the aged care industry. In particular, conditions of their related party financing arrangements.

22. To assist all taxpayers to self-assess the tax risk of their financing arrangement, we published PCG 2017/4 *ATO compliance approach to taxation issues associated with cross-border related party financing arrangements and related transactions*.

23. We are reviewing the application of the transfer pricing rules to financing arrangements of entities in the aged care industry.

24. Financing issues also include hybrid arrangements, often involving limited partnerships or redeemable preference shares. We expect the OECD hybrid mismatch measure will address this.

Use of tax consolidated groups

25. There are a number of entities in the aged care industry who operate through a multiple entry-point consolidated (MEC) group. This in itself does not raise tax compliance concerns and is not an aged care industry specific issue. But it has the potential to obscure intra group transactions for financial or public tax reporting, especially where there are limited partnerships in the structure. Under the consolidation rules, the subsidiary members of a consolidated or MEC group are treated as part of the head company of the group for income tax purposes while they are members of that group.

26. MECs are commonly used by foreign owned groups operating in the aged care services industry. These structures are usually not adopted for tax reasons, but reflect a history of keeping different types of business under different parts of a multinational group and growth by acquisition.

27. Financial reporting requirements are typically on an entry point by entry point basis. As such, a foreign group operating as a MEC will generally not be required to lodge a single aggregate set of accounts for its Australian operations (and may have different levels of financial reporting obligation for different entry points). This can make it difficult for the public to understand the full operations of the foreign group in Australia.

28. We encourage greater transparency by these groups through adoption of the Board of Taxation's Voluntary Tax Transparency Code and/or best practice adoption of the general purpose financial statements (GPFS) measure applicable to significant global entities (which recommends filing of an aggregated set of GPFS for the entire Australian operations of the foreign group).

Use of trusts

29. The use of unit and discretionary trusts as vehicles to operate aged care facilities is a common feature of privately owned groups in the aged care services industry. Often this is explained by the desire to isolate the commercial risks of operating a particular facility from the broader group, while maximising the group's capacity to self-finance its activities as a whole.

30. However, as trusts are not taxable entities (the ultimate beneficiaries of trust income bear the obligation to pay income tax) the use of trust structures means it is often not possible to identify the tax payable based on publicly available information alone. In addition, private trusts will often not be required to prepare financial statements.

31. In rare cases, trusts are used in conjunction with other tax planning or avoidance strategies to artificially reduce the tax payable on underlying business operations. There are a number of general and specific anti-avoidance rules we can apply to ensure the appropriate amount of tax is paid, in relevant circumstances.

Employer obligations

32. We are currently reviewing the in-home care and other sectors of the aged care services industry to understand their current and emerging worker engagement (employee or independent contractors) models whether direct or through labour hire. The income tax, superannuation and fringe benefit obligations differ depending on whether these entities engage employees or contractors, and there is the potential for casual employment arrangements to be incorrectly characterised as contractor relationships.

33. Where we identify employer obligation issues, we will work with the relevant entities and their workers to address the issues to ensure the appropriate obligations (such as pay as you go withholding tax and fridge benefits tax) and superannuation entitlements are met. This will help to protect the entitlements of workers in the sector and ensure a level playing field for entities operating in the industry.

Issues specific to retirement villages

34. Common practice in the retirement village sector is to structure arrangements with residents using loan/lease or loan/licences. The ATO view, as outlined in TR 2002/14 *Income tax: taxation of retirement village operators*, is that ingoing contributions by residents under loan/lease or loan/licence arrangements are not assessable income.

35. TR 2002/14 also states the ATO view that retirement village construction costs are on capital account.

36. Given the concessional treatment of these arrangements, we consider the income tax risk of non-compliance in this sector to be very low.

37. We are aware of issues surrounding the treatment of certain liabilities for the purposes of the exit allocable cost amount (ACA) calculation where TR 2002/14 applies. We are currently developing a draft PCG to provide guidance to taxpayers on these issues to help them to more easily comply with their tax obligations.

38. Other issues arising from the application of section 701-55 (setting the tax cost of an asset) to retirement villages operating within a consolidated group have largely been dealt with legislatively.

39. Steps are being undertaken to ensure that the ATO deals with industry on both income tax and GST issues in a more holistic way.

Goods and services tax

GST status of aged care services

40. Government-funded residential care services and the associated accommodation are GST free. Where the supplier does not receive government funding, residential care and the associated accommodation is only GST-free if the resident has a sufficient level of care needs. Supplies to other residents of retirement villages are not residential care and are generally not GST-free.

41. Most home care services are GST-free if the supplier receives government funding. A much smaller range of care services are GST-free if the supplier does not receive government funding.

Aged care accreditation

42. Approved providers of residential care under the *Aged Care Act 1997* are required to be accredited. Where a provider fails to obtain accreditation or loses their accreditation, some or all of their supplies may not be GST free. We seek to identify those without accreditation to determine if they are accounting for GST correctly.

Risks arising from arrangements intended to increase input tax credit claims

43. Most residential accommodation in retirement villages are input taxed. We have observed some arrangements where input tax credits have inappropriately been claimed. One example is how supplies and entitlements are accounted for between entities from the same economic group, but not necessarily the same GST group.

44. Additionally, some retirement village operators seek to disaggregate supplies that generally form part of the input tax supply of accommodation to obtain greater input tax credits.

Claims of 'dual intention'

45. We are aware of issues surrounding claims of dual intention, which are often not substantiated by the evidence provided. We closely scrutinise these claims because they potentially distort the GST apportionment formula.

Commercially committed

46. We have seen issues with the interpretation of the GST transitional provisions for retirement villages (GSTR 2009/4 *Goods and services tax: new residential premises and adjustments for changes in extent of creditable purpose* and GSTR 2011/1 *Goods and services tax: development, lease and disposal of a retirement village tenanted under a 'loan-lease' arrangement*). Some entities have claimed costs are commercially committed despite the related entity making the claim not existing at the time the costs were incurred.

Appendix

ATO submissions to the Senate Economics References Committee on Corporate Tax Avoidance

- *Inquiry into corporate tax avoidance and minimisation* (February 2015)
- *Inquiry into corporate tax avoidance and minimisation and Australia's offshore oil and gas industry* (30 March 2017)
- *Inquiry into corporate tax avoidance and minimisation* (31 January 2018)

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