

Senate Hearing on International Corporate Tax Avoidance

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Topics

- G20/OECD Base Erosion and Profit Shifting (BEPS) Project
- Risks of BEPS failure or breakout
- Australian corporate tax base, rate and enforcement
- Imputation and tax avoidance
- Corporate tax avoidance in Australia: Foreign and resident companies

Messages:

- (1) **International corporate tax is not a simple issue with simple single-country solutions**
- (2) **Major tax issue for Australia likely to be foreign corporates with local sales**

G20/OECD BEPS Project

- Corporate tax is essentially a source based tax on business income
 - Ultimate shareholder tax (dividends, CGT) is the residence tax
 - International tax system designed to remove double taxation at corporate level; up to shareholder country to deal with that level
- BEPS project necessary response to pressures on source taxation
 - Systemic issues
 - Difficulty of defining source for digital economy
 - Harmful tax practices to shift tax base (rulings, patent boxes)
 - Tax competition: mobility of (some) real investment
 - Design issues: locating tax base and enforcing it
 - Defects in transfer pricing rules
 - Defects in treatment of interest deductions
 - Defects in business tax threshold (permanent establishment)
 - Defects in information, enforcement, implementation

Risks of BEPS failure or breakout

- BEPS project plausibly assumes that international coordination is necessary to overcome problems
 - Not the first attempt
 - OECD 1998 Harmful Tax Competition project failed due to withdrawal of US support (except for transparency)
 - BEPS could fail because of US gridlock?
 - Project is being inoculated against this possibility with defensive rules: G20 political consensus critical
- Packs large scale remaking of international tax system into 2 years (system took 80 years to build in 20th century)
 - Extremely short-term for technocrats, long-term for politicians
 - Risk of political breakout, eg UK DPT and election
 - Delicate line of prodding process forward while maintaining consensus means advance national action needs to be carefully considered (build rather than destroy consensus)

Australian corporate tax base, rate, enforcement

- Base has differing components
 - Natural resources/primary production exposed to world prices but not too much competition
 - Australian based large businesses with local customers enjoy tyranny of distance & regulation (large local banks, grocers, etc)
 - Local internationally competing businesses very exposed (manufacturing, some services)
- Tax rate is not significantly out of line (compare weighted and unweighted averages)
 - Corporate tax cut very unfocused in dealing with areas where tax competition an issue (benefits all other areas including HWIs)
 - Change base in areas affected by tax competition
 - Reduce rate but with adjustments to deny benefits to unaffected businesses
- Enforcement: ATO regarded as unstrategic but changing
 - Parliamentary enquiry 25 years ago on some similar issues

Imputation and tax avoidance

- Tax discussion paper page 83
 - Corporate tax \$65b
 - Imputation credits claimed by residents \$19b
 - Imputation credits on distributions to non-residents \$12b
 - Imputation credits on distributions to resident companies \$10b
 - Retained earnings/timing differences \$24b
- Extremely high distribution ratios and rate of fully franked dividends
 - Puts floor under tax avoidance by most large resident corporates
 - One reason for recent high tax collections (also mining boom)
- Henry review and discussion paper (less strongly) recognise integrity benefits but question imputation overall (based on yet to be disclosed Treasury modelling for discussion paper)
 - Assumptions of modelling likely to be questionable
 - But bias for Australians to invest in Australian companies

Corporate tax avoidance in Australia: Foreign and resident companies

- Foreign corporates:
 - No imputation incentive to pay Australian corporate tax
 - Not such a need for large operations in Australia (depending on sector)
 - Leading to potential transfer pricing, business tax threshold, interest deduction, enforcement issues
- Resident corporates with mainly local operations/customers
 - BEPS not such an issue (imputation, profit stripping more difficult) except perhaps closely held businesses
- Resident corporates with significant foreign operations/customers
 - BEPS more of an issue but double-edged
 - May have greater opportunities for Australian base stripping which could be countered by BEPS but imputation moderates
 - May be exposed to greater foreign tax (and less Australian tax as a result) for good and bad BEPS reasons