

Department/Agency: ATO

Question: 1

Topic: Tax paid formula

Reference: Hansard page 8

Senator: Dastyari

Question:

CHAIR: Mr Hirschhorn, from what Mr Jordan said earlier, there was a proposition that, if we were to go back to these companies, there would be—and I assume you will take this on notice—a formula that you could provide the committee to allow us to be able to compare like with like in how we do that calculation. Is that a simple formula that you can explain now, or is it a complex matter that should be taken on notice?

Mr Hirschhorn: I will not discuss the formula in detail, but it might be worth just spending a minute or two, if that would help the committee. We saw that effective tax rates were being used. In any rate, there is a numerator and a denominator. In some cases, the numerator used was an income tax expense, an accounting concept, rather than a 'tax paid' concept. I think what the committee would be interested in is tax paid.

CHAIR: Yes.

Mr Hirschhorn: And then in 'tax paid' there might be some variants. Do we include tax just paid by that company? Do we include tax paid by its majority owned subsidiaries? Do we include tax that it pays on interest that it pays to another group company? So there are different ways that you could look at: what is 'tax paid'? Do you take into account disputes where they are asking for money back that they have not got back yet, because we are still objecting, or we still have a dispute?

On the denominator, there is even more challenge because most of the numbers were based on accounting profit. Accounting profit can be misleading because, as an example, in the context of an e-commerce company, the accounting profit of the Australian operations does not include any of the sales which are directly booked in Singapore or elsewhere. It could be misleading because it includes billions of dollars of interest expense paid to the parent company, so that suppresses the accounting profit, but in fact that is part of the Australian profit.

Senator EDWARDS: I get it; do not worry!

Mr Jordan: But, just on that point, we were quite surprised, I suppose, that in some cases they would include the interest withholding tax on the billions of dollars of interest paid but not include the interest income, so the tax is actually an expense of the parent, of the recipient of the interest, and they were including that in their numerator but not the income that it was collected on in the denominator—so quite misleading.

CHAIR: Mr Jordan, you are saying that you are challenging the information that we were provided on the effective tax rate, and you are saying the way to get to the bottom of it is to make sure there is a clear, transparent formula, which you will provide to the committee, which we can request to allow us to have that opportunity to compare like with like? I want to thank Mr Jordan and Mr Hirschhorn for taking that initiative and that step.

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Answer:

Please find annexed a minute outlining an “effective tax borne” formula, along with some explanatory notes which are designed to assist in understanding and applying the formula.

The formula is intended to identify an economic group’s total worldwide profit from Australian linked business activities, and the Australian and offshore tax paid on that profit. This will provide an indication of total tax borne as well as the proportion of those profits actually taxed in Australia.

Our development of this formula is continuing, but it is considered that the formula is at a stage of development that means it can provide useful information on effective tax borne on a “like for like” basis.

Note that we have not yet had the opportunity to consult with taxpayers or other stakeholders during the development of this methodology. In the ordinary course of events this is something we would certainly seek to do, however, given the time constraints, this has not been possible to date.

It should also be recognised that views differ as to the appropriate formula to use to calculate effective tax rates and that the response to this methodology is likely to be no different. There is merit, particularly in the context of the debate on multinational tax, in having a standardised approach to effective tax borne to facilitate like for like comparisons (both domestically and internationally). This formula is an option for how that standardised approach might look and is intended to encourage broader discussion about the need for, and appropriateness of, a standardised approach to calculating effective tax borne.

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Annexure A

A consistent and useful effective tax rate methodology to assess the global tax performance of multinationals in relation to Australian-linked business operations

The purpose of this paper is to propose a metric for the global tax performance of multinationals in relation to their Australian-linked business operations.

The formula is intended to identify an economic group's total worldwide profit from Australian linked business activities, and the Australian and offshore tax paid on that profit. This will provide an indication of total tax borne as well as the proportion of those profits actually taxed in Australia.

Our development of this formula is continuing, but it is considered that the formula is at a stage of development that means it can provide useful information on effective tax borne on a "like for like" basis.

Note that we have not yet had the opportunity to consult with taxpayers or other stakeholders during the development of this methodology. In the ordinary course of events this is something we would certainly seek to do, however, given the time constraints, this has not been possible to date.

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The metric

Denominator

The denominator is the total economic group profit from business activities which are linked to Australia. There is a variant which excludes some abnormal items from the profit calculation.

The starting point is the consolidated accounting profit of the Australian group (which may include offshore subsidiaries). To develop the estimate of the total economic group profit from business activities linked to Australia, it is necessary to make a range of adjustments to that profit (especially for inbound multinationals, where the Australian accounts will only be a subset of the economic group's activity).

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Numerator

There are two alternative numerators under the combined metric:

- the Australian tax (including non-resident withholding taxes) paid on those business activities by the economic group;
- the global tax paid on those business activities by the economic group.

General comments

This metric deliberately includes profits of the economic group which may not be taxable in Australia under Australia's source, residency and anti-profit shifting rules or the OECD / Double Tax Agreement principles intended to avoid double taxation. The metric seeks to reflect all of the channel profit derived from business activities involving Australia and the Australian and global tax paid on that channel profit.

Alternative methodologies, which are simply based on consolidated Australian accounting profit without adjustment (especially for inbound multinationals), beg the question around appropriate pricing of international related party dealings and whether they are at arm's length. By including the entire economic group's profit from Australian linked activities, international related party dealings are effectively ignored.

Under the metric, where some of an economic group's activities are undertaken in low tax jurisdictions, the average global tax rate may legitimately be below (or significantly below) the Australian corporate tax rate. By including a metric which incorporates global tax, it will demonstrate a weighted average global tax rate on those business activities. In reporting this metric, a taxpayer may wish to provide an explanation of the proportion of profits taxable in relevant jurisdictions.

The amount of Australian tax paid will reflect the impacts of tax policy settings (ie the legislative rules that define the Australian tax base, any tax expenditures taken into account in the tax reconciliation process and tax credits and offsets that may be available) as well as the impacts of any base erosion and profit shifting activities.

The methodology seeks to align the Australian accounting consolidated group with the Australian tax consolidated groupings and aggregation of Australian tax payments may be needed in some cases where there is more than one tax consolidated group in the economic group.

The analysis is designed to apply equally to Australian headquartered entities that are purely domestic (domestic entities), Australian headquartered entities that also have offshore investments (outbound MNEs), and foreign headquartered entities that have investments in Australia and may also be using Australia as a regional headquarters (inbound MNEs).

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The elements raised in this paper are indicative and are unlikely to be exhaustive. In applying the metric to a particular taxpayer:

- The general principles of the paper should be applied as far as possible where there are scenarios not contemplated in the paper;
- If the methodology is considered to provide a misleading outcome in the particular circumstances, this should be disclosed;
- Where it is not possible to obtain precise information in relation to particular adjustments, a “best estimate” approach should be adopted within materiality principles.

Comments in relation to profit of the economic group

The methodology starts with the accounting profit of the Australian economic group. This will include offshore subsidiaries of the Australian economic group, but will not include offshore parent entities or sister entities.

A series of adjustments are required to be made to:

- Include economic group profit from business activities which have an Australian element but are not included in the consolidated accounts of the Australian accounting group (relevant primarily to inbound MNEs);
- (Potentially) exclude economic group profit (and the related tax) from operating businesses in offshore subsidiaries which have no Australian connection (relevant primarily to outbound MNEs).

Where transactions with offshore entities are already within the consolidated Australian accounting group, no adjustment is required as the third party income and expenses are already reflected in the consolidated Australian accounting group and the effects of related party dealings (both onshore and cross-border) are washed out in the course of the accounting consolidation process.

The specific adjustments are discussed below.

Income earned from Australian residents by offshore companies not within the Australian accounting consolidated group

The economic group may earn income from Australian residents outside the Australian accounting consolidated group.

This revenue should be included in determining the profit to the economic group attributable to the Australian business operations.

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Third party costs incurred in deriving that revenue should similarly be included (which could include purchases from third party suppliers, depreciation on plant and equipment etc).

Purchases and other services from offshore related parties

Where the Australian accounting group *purchases* goods and services from offshore related parties, the offshore entity will usually make a profit (offshore) as part of that supply chain.

Under the metric, the entire supply chain profit is a profit of the economic group arising from Australian business activities.

As such, the profit of other group companies from these sales should be included in the metric.

This means that accounting profit should be adjusted to exclude payments for goods, services and intellectual property from related parties, but should then be adjusted to include third party expenses in manufacturing / purchasing the goods, providing the services and/or developing the intellectual property. This could include depreciation / amortisation of plant or capitalised intellectual property costs.

This would include profit made offshore on agency sales by related selling agents.

Sales to offshore related parties (including trading hubs)

Where the Australian accounting group *sells* goods or services to offshore related parties, the offshore entity will usually make a profit as part of that supply chain.

Where that profit is not already included in the Australian accounting profit, the economic group profit should be adjusted accordingly.

This could be implemented by adding the profit of the offshore entity or by excluding the sales revenue earned from the related party, and replacing with the revenue from its on-sales to third parties, less its other third party expenses (including employee costs).

Excessive debt allocations to Australian entities

The Australian group will have third party debt attributable to its operations (and the related interest expense in its financial accounts).

It may also have related party debt from its offshore parent / sister companies (occasionally but rarely from offshore subsidiaries).

For the purposes of this methodology, it is assumed that interest on third party debt is a legitimate business expense of the Australian operations (noting that in some cases that debt may actually be extended on the security of offshore subsidiaries).

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Related party debt may reflect:

- A specific on-lending of third party debt raised offshore;
- A general on-lending of third party debt (resulting in the Australian operations having the same level of third party indebtedness as the entire group); or
- An incremental gearing level in Australia over the group's level.

In relation to the first two categories, any margin earned by the related party on the on-lending is a profit to the economic group attributable to the Australian business operations.

In relation to the third category, the incremental interest income of the related party is a profit to the economic group attributable to the Australian business operations.

Similar principles apply in relation to other financing elements such as related party derivatives and foreign exchange gains and losses.

Equity accounted subsidiaries

There are complexities relating to equity accounted subsidiaries (ie subsidiaries where there is a significant holding, but not enough to tax consolidate).

There are three proposed approaches:

- to include the relevant percentage of their profits in the economic group profit (and following on from this, the relevant percentage of their tax); or
- to exclude the profit attributable to equity accounted subsidiaries, but to then include dividends from the subsidiaries in economic group profit (potentially "grossing up" for underlying tax borne at the subsidiary level).
- To exclude the profit attributable to equity accounted subsidiaries entirely.

Any of these approaches should be acceptable

Abnormal items

Accounting profit in a particular year may be artificially suppressed (or inflated) through impairments or revaluations of intangible or other long term asset holdings (such as property).

These amounts should be excluded to provide a normalised accounting profit.

Other extraordinary items should also be excluded where appropriate.

Comments in relation to tax paid

Use of tax paid rather than income tax expense

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The proposed metric is based on tax actually paid in relation to a period rather than income tax expense according to accounting concepts.

In this regard, income tax expense for accounting purposes may include amounts which are not likely to be paid / received in the short to medium term (“deferred tax expense”). It may also include amounts such as “risk provisions” for potential tax disputes. On the other side, it may be artificially low through the generation of carry forward losses in part of a group, which cannot be offset against gains from another part of the group.

Some taxpayers may wish to provide a reconciliation of total income tax expense to tax paid (primarily the amounts which make up deferred tax expense, although there may be some current tax expense items). Many of these items will be impacts of deliberate tax policy settings (for example accelerated depreciation).

This could include elements such as:

- Tax losses recouped
- Accelerated depreciation for tax purposes (including immediate write-offs of items such as exploration expenditure)
- Deferred tax liabilities for “top up” tax under offshore CFC regimes

Exclusion of royalties and excise

It is not proposed to include royalties and excise in the metric as these are not generally considered to be income taxes and apply to some but not all industries.

However, it is important to note that these taxes do contribute to the total contribution to Government of an economic group.

Withholding taxes

Where an amount of income is included in economic group profit (eg through adjusting to include interest income received by offshore companies from Australian entities), the relating Australian withholding tax should be included in Australian tax paid.

Offshore tax

Where a profit or margin earned by an offshore entity is included in economic group profit, that tax should be included in the global tax paid.

This will include tax paid on those profits in third countries under controlled foreign company rules and/or on repatriation of those profits.

Equity accounted subsidiaries

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Depending on the methodology adopted for equity accounted subsidiaries, different approaches need to be taken in relation to underlying tax.

- Under the first methodology, the relevant proportion of underlying tax paid should be included;
- Under the second methodology, an amount should be included based on the average underlying tax rate applicable to the equity accounted subsidiary (effectively “grossing up” the after tax profits distributed to a pre-tax amount);
- Under the third methodology, no amount should be included.

Disputed amounts of tax

Where there are significant disputes in relation to tax payable (for example, taxpayer objections or litigation in relation to returns lodged, or requests for amendment not yet processed), these should be separately disclosed and an adjusted metric separately provided.

Where there is an amended assessment and there has been an arrangement to pay half the tax in dispute, different approaches can be taken:

- Include the arrangement amount with no further disclosure;
- Include disclosures around best/worst case scenarios (i.e. reflecting the positions where either party is successful in litigation); or
- A probability approach based on litigation risk

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Methodology

Comprehensive normalised profit

Consolidated accounting profit of Australian entities / branches (including offshore subsidiaries)

Adjustments for income earned from Australian residents by offshore companies not within the accounting consolidated group

- Add sales to Australian residents not included in Australian group accounting profit
- Include third party costs incurred overseas in deriving those sales (eg purchases from third party suppliers) not already included in Australian accounts

Adjustments for purchases and other services from offshore related entities

- Exclude cost of goods sold on items purchased from related companies (which are not in the Australian accounting group)
- Include third party costs in manufacturing / purchasing those goods*
- Exclude cost of other property purchased from related companies (which are not in the Australian accounting group), eg, debts sold in a factoring business
- Include third party costs in manufacturing / acquiring that property *
- Exclude expenses for services from related companies (which are not in the Australian accounting group), including management and administrative services
- Add profit made offshore on agency sales by related selling agents (which are not in the Australian accounting consolidated group)
- Include worldwide third party costs of those services not already included in Australian accounts*
- Exclude royalty expenses for intellectual property obtained from related companies (which are not in the Australian accounting consolidated group)
- Include third party expenses incurred in developing such intellectual property not already included in Australian accounts*

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Adjustments for sales to offshore related entities

- Add profit made offshore in trading hubs (which are not in the Australian accounting consolidated group)
- Add profit made offshore in other subsidiaries from the on-sale of goods and services acquired from Australian entities (net of amounts already included in Australian accounting group by way of sales or other revenue)

Adjustments for excessive debt allocations to Australian entities

- Exclude interest expense on loans from related companies (which are not in the Australian accounting consolidated group)
- Include interest expense on third party loans where those loans are specifically on-lent to the Australian group
- If Australian group has third party borrowings (and specifically on-loaned amounts) less than worldwide level, include estimated share of worldwide third party interest expense required to bring Australian group to average level of third party borrowing (average debt load at average rate)
- Exclude income and expenses for derivatives with related companies (which are not in the Australian accounting consolidated group) (to the extent the economic group has not entered into back to back derivatives with third parties)
- Exclude foreign currency gains or losses on loans or derivatives from related companies (which are not in the Australian accounting consolidated group) (to the extent the economic group has not entered into back to back transactions with third parties)
- Include any third party costs of foreign currency hedging for Australian dollar exposure for Australian dollar funds provided to Australian group if not already included in Australian accounts*

Adjustments for equity accounted subsidiaries

Depending on methodology adopted:

- Adjust to include relevant percentage of profits
- Exclude all profits attributable to the equity accounted subsidiaries; and/or
- Include dividends received from equity accounted subsidiaries (potentially “grossed up” for tax)
- Subtract profit attributable to equity accounted minority holdings in subsidiaries

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* Third party expenses or costs which relate to both the Australian operations and to non-Australian operations should be allocated in accordance with the segment accounting principles in paragraphs 25 to 27 of AASB 8.

Comprehensive profit (A)

- Exclude revaluations / impairments on intangibles
- Exclude other extraordinary items where appropriate

Comprehensive normalised profit (B)

Effective tax paid

Australian corporate tax actually paid in relation to the period

- Add: Australian interest withholding tax paid on related company borrowings (to extent interest income included in adjusted group profit)
- Add: Australian royalty withholding tax paid on related company royalties (to extent royalty income included in adjusted group profit)
- Add: Australian dividend withholding tax paid on dividends remitted (to extent dividend income included in adjusted group profit)
- Add: (assuming relevant approach taken to equity accounted subsidiaries) proportionate share of Australian corporate tax actually paid by non-100% subsidiaries where profit included in Australian consolidated accounting group
- Add/Subtract: amended assessments / objections / requests for refunds of tax not yet processed

Total effective Australian tax paid (C)

- Foreign tax paid on business operations included in accounting group consolidated profit
- Foreign tax paid on related party interest income (to extent included in adjusted group profit)
- Foreign tax paid on related party royalty income (to extent included in adjusted group profit)
- Foreign tax paid on dividends received from Australian group (to extent included in adjusted group profit)

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- Foreign tax paid on profit on goods sold to Australian group (to extent included in adjusted group profit)
- Foreign tax paid on related party services income (to extent included in adjusted group profit)

Total effective foreign tax paid (D)

Total effective global tax paid (E) (C + D)

Metrics to assess the global tax performance of multinationals in relation to Australian linked business operations

Australian tax performance on Australian linked business operations

Australian effective tax paid ratio: C/A

Australian normalised effective tax paid ratio: C/B

Global tax performance on Australian linked business operations

Global effective tax paid ratio: E/A

Global normalised effective tax paid ratio: E/B

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Department/Agency: ATO

Question: 2

Topic: Advanced pricing arrangements

Reference: Hansard page 9

Senator: Ketter

Question:

Senator KETTER: Okay. I turn to this issue of advanced pricing agreements. Let us take the example of Apple. They have had one for a number of years. I think they said they have had an advanced pricing agreement for 10 years or so. They have said that negotiations for a renewal of that agreement have been suspended because of the audit that is going on in respect of a number of companies. Can you tell us about the other companies that are involved in that general industry audit?

Mr Konza: There are 12 companies in the e-commerce IT area that we have under review either for using structures that do not declare sales in Australia or for using aggressive transfer pricing to shift profits out of Australia. We are doing an industry review to get a good understanding of all the tax planning that is used in that area.

Senator KETTER: So there is no renewal of advanced pricing agreements for any of those 12 companies or do some of those companies have APAs extending into the future?

Mr Konza: Any company that we think is involved in the more aggressive tax planning we are not allowing onto the APA application program.

Senator KETTER: Can you tell us the number of companies involved there?

Mr Konza: No, not off the top of my head, I am sorry—because what you are asking is how many people did we not let onto the program, and I do not know that figure.

Senator KETTER: All right.

CHAIR: Can you take that on notice?

Mr Konza: Sure, we can take that on notice.

Answer:

There have been 12 APA applications that have not been allowed into the APA program because they demonstrate signs of aggressive tax planning. The issues in these cases are more appropriately being dealt with by alternative compliance activities.

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Department/Agency: ATO
Question: 3
Topic: Google
Reference: Hansard page 10
Senator: Ketter

Question:

Senator KETTER: Turning to Google, I think there was some evidence—and I am not sure if somebody from the tax office was there at the time—from News Corporation that there is an amount of revenue that Google is sending overseas. Do you have some views on that?

Mr Konza: It is widely public knowledge that, with the types of arrangements Google are involved in, they do not land the income in Australia in the first place. Now, these companies—

Senator KETTER: Can you verify the amount that is being reported?

Mr Konza: We would have to take that on notice because I do not have those figures in my head. When the companies were here, you spoke about the double-Irish Dutch sandwich with them. I might just make the general observation, because it might help explain things, that the industry trend over the last few years has been either to move from Ireland or to more generally split their worldwide earnings through both Ireland and Singapore, still using basically the same sandwich approach to get money to, as in some of the cases we have identified, Bermuda, because it has a zero corporate tax rate.

Answer:

The ATO can verify that the revenue derived by the Google Group from Australian customers up to the year ended 31 December 2012 was reported by Google Asia Pacific Pte Ltd (in Singapore) and Google Ireland Ltd (in Ireland), and was not reported at all in Australia.

Google Australia Pty Ltd received income directly from Google Asia Pacific Pte Ltd and Google Ireland Ltd (under an internal service agreement) for providing marketing and sales functions related to revenue received by Google Asia Pacific Pte Ltd and Google Ireland Ltd from Australian customers. Google Australia Pte Ltd also received income (under a Google internal service agreement) for providing research and development services to Google Inc.

In the published financial accounts of Google Australia Pty Ltd for the year ended 31 December 2012, reported income under these internal service agreements was \$AUD 267,062,658 and current tax payable was \$AUD 6,160,498.

In the published financial accounts of Google Australia Pty Limited for the year ended 31 December 2013, reported income under these internal service agreements was \$AUD 355,586,016 and current tax payable was \$AUD 7,071,343.

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Department/Agency: ATO

Question: 4

Topic: Complaints from staff

Reference: Hansard page 17-18

Senator: Milne

Question:

Senator MILNE: In the last three years—the commissioner can maybe respond—have you received any internal complaints from staff who are issuing notices for information to be provided, RFIs, or asking to have section 264 notices put in place? Have you received any internal complaints that, when these notices are issued to taxpayers, there is a resulting bullying, dragging out of time lines, failing to respond or giving inadequate information to questions? If you have had complaints, what has the tax office done about the fact that, once it goes from just a request for information to a section 264, there is a distinct change in behaviour?

Mr Jordan: Is this on the part of the taxpayer that they might have bullied—

Senator MILNE: Bullied the person that they are working with in the tax office. Given you are saying that you are negotiating with these companies all the time, they like it when it is just requests for information, but, when it looks as if it might actually get to the point where you will go with a section 264, they then start bullying. In fact, I have been told they threaten some of the tax officers by saying, 'We've already done a deal with the senior executive service no matter what you say.' I am interested: have there been any internal complaints and what have you done about it?

Mr Jordan: I personally am not aware of any internal complaints, but I will ask my colleagues to respond.

Mr Konza: Tax auditing is not for the faint-hearted. It is a robust process. Clients and their representatives will try it on. What we do is support our staff. I have had various taxpayers over the years who have refused to supply information or behaved very badly. My staff escalate it to me and I ring them and read them the riot act—sort it out. As to deals already being done, I have never heard of such a case and I have never seen a complaint of that nature.

Senator EDWARDS: Say a person like you, Mr Konza, gives a nod and a wink to some senior executive in some company and then completely sells out the people junior to you. Is that the contention? Then they fight this battle that they can never win.

Mr Konza: You would last five minutes in the tax office if you tried that, because our auditors are independent minded people. They will go out and tell people.

Senator MILNE: Perhaps I can put it on notice rather than just have a general discussion here. The commissioner has said he does not know, so I would like to put it on notice. Over the last three years, have you—if not you particularly then the relevant person in the tax office—received any internal complaints from staff who are issuing these notices both for information and for the section 264s to the large taxpayers about bullying? What action has been taken? Maybe you could also provide on notice how many voluntary requests for information have been issued to companies relating particularly to transfer-pricing cases and how many section 264 notices have been issued on compliance relating to transfer-pricing matters.

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Mr Jordan: The latter is probably quite possible because it is more formal. I would flag the former in that just general information requests might be quite difficult to gather.

Senator EDWARDS: Perhaps Senator Milne will put that on notice for you.

Answer:

There have been no formal internal complaints related to bullying around section 264 notices recorded by the ATO.

The table below outlines the total number of section 264 notices issued over the last 3 financial years within the Public Groups and International division of the ATO.

Table: Total number of section 264 notices issued

2011/12	2012/13	2013/14
83	107	78

It is estimated that there would be over 2000 voluntary requests for information in this time period. A further breakdown of this information, including identifying the number of section 264 notices and voluntary requests that are transfer-pricing related, would be an unreasonable diversion of departmental resources.