Australian Government
Australian Taxation Office

Australian Taxation Office Submission

Inquiry into Corporate Tax Avoidance and Minimisation

Contents

Introduction

1. Large companies in Australia have a high level of tax performance. In 2014-15, we estimate large companies paid approximately 94 per cent of the tax payable according to law, 91 per cent prior to, and the remainder as a result of compliance action. This level of compliance is global best practice.

2. Within the context of a high performing tax system, this submission describes the significant progress that has been made in the mitigation of corporate tax avoidance. It describes the permanent improvements achieved, areas of substantial improvement and areas of focus, with the aim of sustainable improvements from an already high base.

3. ***Permanent improvement*** has been achieved through the Multinational Anti Avoidance Law (MAAL). The MAAL is expected to reinstate $7 billion of additional income to the Australian tax base resulting in an estimated $100 million of income tax per annum being permanently restored. It has led to a permanent increase in the GST tax base, with an additional $290 million paid in 2016-17.

4. Importantly, it also brought taxpayers to the table to talk to us about the resolution of their past tax practices. In particular, in the e-commerce industry last year we finalised 11 cases, issued amended assessments worth over $1 billion, collected tax of over $800 million and estimated future company tax wider revenue effects of over $500 million. There are still another 20 major players in the industry we are looking at, but we believe industry now has a better understanding of acceptable transfer pricing parameters.

5. ***Significant improvement*** has been made in other areas. Building on the decision in the Chevron case, Practical Compliance Guideline (PCG) 2017/4[1] on cross border related party financing arrangements has encouraged taxpayers to work collaboratively with us to resolve issues and lock in the future. We raised around $1.5 billion in amended assessments in 2016-17 by addressing various arrangements used to achieve artificial transfer pricing benefits through relating party financing. Already, approximately $75 billion of related party loans have been brought within the PCG framework, with a reduction of about $1.4 billion in interest deductions in the 2018 year alone.

[1] PCG 2017/4 ATO compliance approach to taxation issues associated with cross-border related party financing arrangements and related transactions

6. The use of offshore marketing hubs to avoid tax is also expected to decline because of PCG 2017/1[2]. This guide helps taxpayers assess their own compliance with transfer pricing rules related to offshore hubs. It is up to them to make use of the hub risk assessment framework and ensure they operate within the 'safe zone'. Cases where the taxpayer does not agree with our approaches are being litigated.

7. ***Other areas of work at an earlier stage*** include:

   - compliance in the oil and gas and pharmaceutical industries
   - fragmentation of businesses into stapled group structures
   - the transfer of intellectual property offshore
   - examination of country by country reporting
   - the examination of the Panama and Paradise Papers
   - the prevention of the promotion of tax avoidance schemes by intermediaries
   - new legislation to deal with the significant hybrid risk
   - implementation of the Diverted Profits Tax.

8. We continue to encourage companies to work cooperatively with us by having regard to our practical compliance guidance and taxpayer alerts and by seeking certainty through our rulings and advanced pricing arrangements (APAs) services.

9. Our focus on corporate tax avoidance remains resolute. We are as active as we have been over the last few years to ensure the right amount of tax is paid in Australia.

[2] PCG 2017/1 ATO compliance approach to transfer pricing issues related to centralised operating models involving procurement, marketing, sales and distribution functions

Action taken by the ATO

Compliance

10. Our compliance program is designed to address non-compliance and ensure taxpayers comply with their Australian tax obligations with respect to international transactions and structures. It investigates multinational enterprises that may have shifted profits or restructured their operations to move profits from Australia to foreign jurisdictions. It looks at the full scope of international tax risks and deciphers the linkages. Where it is appropriate, we treat risks in clusters (groupings of common risks and cases) to stop proliferation, and identify new and emerging risks.

11. Appendix 1 provides a summary of our current compliance activity for each specific risk cluster and the results to date.

Liabilities and collections

12. From July 2016 to December 2017, we raised $5.2 billion in liabilities against public groups and multinationals. The ATO has collected $2.8 billion in cash from those liabilities, with nearly $2.2 billion of that amount coming from multinational enterprises.

13. We have broadened how we measure the impact of our work. In 2016-17 we estimated more than $400 million of wider revenue effects resulted from our preventative activities. Through our justified trust initiative we also assured $15.9 billion of income tax as correctly reported and paid in 2014-15 by 22 large public and multinational businesses. This measured assurance is additional to our other assurance, prevention and correction work.

Multinational Anti-Avoidance Law

14. The MAAL[3] is having a positive impact on the behaviours of multinationals operating in Australia. Taxpayers either have or are transitioning to compliant and commercially realistic tax structures.

15. Since the introduction of the MAAL in January 2016 we have identified 221 taxpayers within its scope. As at 31 December 2017, we have:

    - assured 179 taxpayers
    - 42 ongoing MAAL engagements.

[3] MAAL

16. 38 multinationals have brought, or are in the process of bringing, their Australian sourced sales back onshore. As a result of the restructures, we estimate $7 billion of additional income per annum will be returned to the Australian tax base, resulting in an estimated $100 million of income tax per annum.

17. The MAAL is also having a significant impact on GST collections, $290 million of additional GST was paid in 2016-17 by taxpayers who have restructured to recognise an Australian taxable presence, and an additional $206 million in GST has already been collected in 2017-18.

E-Commerce focus

18. In line with evidence provided by some companies to the committee in 2017, our efforts have seen multinational companies operating in the ecommerce/digital economy industry significantly increase the profits declared in Australia and the tax they pay in Australia. The risk in the e-commerce sector is effectively mitigated and moving to a tolerable level based on the settlements achieved across our lead cases, and the message this has sent to the advisors and intermediaries.

19. We have effectively specified acceptable transfer pricing parameters across the e-commerce industry through the execution of our risk treatment strategies. We have reduced the proliferation of artificial e-commerce business models and transfer pricing mischief by reshaping the landscape on transfer pricing and setting new parameters and benchmarks. This has ensured the revenue generated and tax paid in Australia is commensurate with the economic activities and value created in Australia.

20. In 2017, we finalised 11 cases, issued amended assessments worth over $1 billion, collected tax of over $800 million and achieved future revenue effects of nearly $600 million.

21. Compliance activities continue for 20 other major e-commerce taxpayers and we continue to monitor taxpayer behaviour across the wider population to ensure the income tax risks we have managed do not resurface.

Chevron case

22. The Chevron decision[4] in April 2017 was a landmark case and Australia's largest ever tax dispute. It is the first case of its kind that deals with the question of how Australia's transfer pricing rules apply to cross-border related party financing arrangements.

23. The findings of the Full Federal Court are seen as an endorsement of ATO principles on the application of Australia's transfer pricing rules to related party financing arrangements, notably:

    - the arm's length principle is to be applied on the basis that the Australian entity retains its characteristics as a member of a global group; that is, you do not treat it as a standalone entity for the purpose of pricing the debt
    - related party financial transactions need to reflect the terms and conditions that would reasonably be expected to exist in truly independent, third party dealings with respect to the taxpayer's circumstances (i.e. as a member of a global group).

Related party financing

24. We have been very effective at addressing past non-compliance with transfer pricing rules in respect of related party financing arrangements.

25. In 2016-17, we issued around $1.5 billion in amended assessments to large public groups and multinationals in respect of arrangements they had used to achieve artificial transfer pricing benefits through related party financing.

26. PCG 2017/4 sets out our approach to cross-border related party financing arrangements. This guidance reflects principles endorsed by the Chevron decision. It also serves as a framework to help taxpayers assess the likely compliance risk of their financial arrangements. The guideline sets out the characteristics of arrangements we consider high risk. It is also designed to provide more certainty to businesses by identifying arrangements likely to be considered low risk.

27. Our related party financing strategy has ensured certainty for the future taxes to be paid by many companies.

28. We have already resolved a number of large cases on a basis consistent with the PCG, with companies choosing to work collaboratively with us to resolve audits, adjust their arrangements and lock in certainty for future tax compliance.

[4] Chevron decision

29. We are being firm with taxpayers looking to settle with us and making it clear we will only do so where we can also lock in future compliance to achieve certainty of appropriate tax outcomes.

30. During 2015-16, there was approximately $420 billion in related party loans into Australia. Of this:
    - almost half of related party loans were in the energy and resources sector
    - approximately one-third ($140 billion) of related party loans were in the oil and gas industry
    - about 43 taxpayers had related party interest expense of over $50 million
    - of these, approximately 26 taxpayers had $100 million or more in interest expense.

31. Over one-third of related party debt into Australia (approximately $150 billion) has been or is currently subject to review activity.

32. Agreements reached with a number of taxpayers on the application of the transfer pricing laws to their related party financing arrangements have resulted in:
    - approximately $75 billion in related party loans transitioning into low risk arrangements in accordance with PCG 2017/4
    - an estimated reduction of $1.4 billion in interest deductions for year ending 30 June 2018
    - an estimated reduction of at least $13.7 billion in interest deductions for the next 10 years.

33. The total amount of related party debt assured is expected to increase over the next 12 months to between $90 billion and $100 billion as we resolve matters that we are currently engaged on (via settlement and/or the issuing of amended assessments).

34. In the course of 2018, we will be expanding the PCG to cover related areas such as guarantee fees and related party cross border derivatives.

Marketing hubs

35. Marketing hubs continue to be a key focus area in 2018. 38 arrangements have been or are currently being reviewed and we are actively working with taxpayers to resolve these matters. Litigation has commenced with Glencore. We expect there will be further litigation of strategic cases.

36. With action taken on traditional hub arrangements, we are now looking at the oil and gas industry and soft commodities for the next phase of this work.

37. PCG 2017/1, published in January 2017, assists taxpayers to risk assess the transfer pricing outcomes of their offshore hubs arrangements. We are expecting the first risk ratings to be disclosed to us in July 2018. The disclosure of the rating enables us to better detect and tailor our engagement appropriately, having regard to the particular risk profile of each hub.

Debt creation

38. The Orica decision[5] by the Federal Court was a significant win in relation to the use of Australia's anti-avoidance rules (Part IVA) where multinationals enter into financing arrangements for tax avoidance purposes (debt creation).

39. We are concerned about cases where an Australian entity funds an overseas related party, but subsequently receives the funds back in a manner that could generate Australian tax deductions without generating corresponding Australian assessable income. These transactions have no commercial driver other than the tax deductions received.

40. We are currently reviewing a number of arrangements with these features. The arrangements under review involve the round robin movement of funds where:

    - an entity claims income tax deductions in Australia for costs of borrowing from an offshore related party
    - the loan provided by the offshore related party is in substance funded, directly or indirectly, by an investment by (or other wealth transfer from) the entity claiming the deductions or its Australian associate
    - the return on the Australian investment, reflecting the financing costs payable to the overseas party, comes back to Australia in a non-taxable or concessionally taxed form, or goes back to shareholders without re-entering Australia.

41. We published Taxpayer Alert TA 2016/10[6] to highlight examples of similar arrangements and outline our concerns to taxpayers.

[5] Orica decision

[6] TA 2016/10 Cross-border round robin financing arrangements

Key risks and projects

Intermediary strategy

42. We recognise the vast majority of tax professionals support the integrity of the tax system. We work with them and explain our concerns at the earliest opportunity. In this way, we enable them to provide appropriate advice to their clients. We develop our approaches using our strong relationships with tax professionals and their representative bodies.

43. As a matter of priority, we are taking steps to deal with advisers who undermine the integrity of the tax system, including those who seek to cloak the promotion of unacceptable tax planning via inappropriate claims for legal professional privilege.

44. We issue formal notices to intermediaries that are known to be associated with arrangements covered by some of our Taxpayer Alerts. The notices ask for information and documents for clients (taxpayers) to whom the firm provided advice. Being formal notices, the firms need to respond.

45. Sanctions for tax planning that exceeds acceptable boundaries include the Promoter Penalty Regime and referral to the Tax Practitioners Board.

Oil and gas industry

46. The following table provides an update on the focus areas outlined in the March 2017 submission to the Committee.

Focus area	Risk	Summary/update
Exploration expenditure	-	We are developing review procedures to be used in conjunction with PCG 2016/17[7] and Taxation Ruling TR 2017/1[8]. These are due to be released in the first quarter of 2018.
Hubs	Shipping	We are drafting a schedule to PCG 2017/1[9], addressing how we will apply compliance resources to the: - pricing of related party transportation services agreements for the crewing and/or use of a ship - excessive cost allocated to a shipping component in a sales contract which may reduce the total sales booked in Australia. The draft schedule is expected to be released for consultation in the first quarter of 2018.
	Non-core procurement hubs	We are drafting a schedule to be included in PCG 2017/1 to provide indicators for non-core procurement activities. A draft will be released for public consultation by 31 March 2018.
Related Party Financing	Debt funding	We published the final PCG 2017/4[10], including Schedule 1, in December 2017, to provide guidance on where we see transfer pricing risks in relation to cross-border related party loans.
	Derivatives / avoiding Withholding Tax / Cross Currency Interest Rate Swaps	We are drafting a schedule to be included in PCG 2017/4 to address arrangements involving cross border related party derivatives. The draft schedule is expected to be released for public consultation by 31 March 2018.

47. Additional areas which we are seeking to treat in 2018 onwards:

Focus area	Risk	Summary/update
Classification of expenditure (revenue versus capital)	Labour costs associated with the construction of assets	We are concerned about the treatment of labour costs associated with the construction of assets. We are seeing taxpayers challenge the capital treatment of these costs (apportioned where necessary) and instead are claiming this expenditure as an upfront deduction under section 8-1 of the *Income Tax Assessment Act 1997.* Given the significant capital expenditure and investment in Australia's oil and gas industry and value of assets constructed, the incorrect classification and attribution of certain labour costs may have a considerable impact on tax collections. We are conducting some reviews on this and considering the development of further guidance. We are also concerned about the treatment other 'general' indirect costs associated with the construction of assets, and are currently conducting further analysis on the treatment of these costs.

[7] PCG 2016/17 ATO compliance approach - exploration expenditure deductions
[8] TR 2017/1 Income tax: deductions for mining and petroleum exploration expenditure
[9] PCG 2017/1 ATO compliance approach to transfer pricing issues related to centralised operating models involving procurement, marketing, sales and distribution functions
[10] PCG 2017/4 ATO compliance approach to taxation issues associated with cross-border related party financing arrangements and related transactions

Pharmaceutical industry

48. Transfer pricing is the main risk we are investigating in the pharmaceutical industry. We are examining arrangements to determine whether Australian subsidiaries and their offshore related parties are operating under arm's length conditions, such that the income declared reflects the economic contribution of the Australian operation to the Australian, and global value chain.

49. The risk is being managed through our APAs and audit program and ongoing stakeholder engagement. The audits and APAs underway will provide evidence of the conditions operating between related entities and the economic basis of the ATO view. This will then be adapted and applied across the population.

50. Our tax risk concerns have been refined to reflect the intricacies of the Australian pharmaceuticals industry and its sub-divisions, for example, patented pharmaceuticals, generic pharmaceuticals, medical devices, and over-the-counter vitamins and supplements. As part of the review of the industry, we are consulting with key Commonwealth agencies (administrators for the Pharmaceutical Benefits Scheme and Therapeutic Goods Administration) and industry associations.

51. As well as transfer pricing, we are also examining risks such as related party financing, thin capitalisation, consolidations, and research and development.

Fragmentation of business structures

52. We issued Taxpayer Alert TA 2017/1[11] to raise concerns about arrangements that fragment trading businesses in order to re-characterise income from trading to passive income earned by a trust. The alert was in response to an emerging behaviour in the market, and not long-standing use of similar structures or ATO-endorsed structures. We continue to apply compliance resources and provide advice to taxpayers consistent with the concerns outlined in the alert, including:

    - moving to audit taxpayers
    - managing private ruling requests
    - providing risk ratings of proposed transactions to the Foreign Investment Review Board.

53. We released our draft Privatisation – Australian Federal Tax Framework guidance for consultation on 31 January 2017. This framework outlines our position on standard-form infrastructure and privatisation transactions.

[11] TA 2017/1 Re-characterisation of income from trading businesses

54. As at 31 January 2018, the government has not made any announcements following Treasury's consultation on Stapled Structures, which closed 31 July 2017.

Diverted Profits Tax

55. The Diverted Profits Tax[12] (DPT) enables the ATO to address multinational tax avoidance where significant global entities (SGEs) divert profits offshore through related party arrangements to avoid Australian tax. This law also encourages SGEs to provide sufficient information to the ATO to allow for the timely resolution of tax disputes.

56. We continue to consult with advisors and other taxpayer representatives in developing the suite of guidance products supporting the DPT measure. The draft Law Companion Guide LCG 2017/D7[13] was published in December 2017, with comments invited by February 2018. Consultation for the draft Practice Compliance Guide is expected to occur shortly.

Transfer of intellectual property offshore

57. We are investigating arrangements that result in the migration or artificial allocation of intangible assets, and rights in those assets, to offshore related parties by multinationals. These arrangements present a risk as multinationals implement non-arm's length arrangements that:

- migrate or artificially allocate Australian generated intangibles to offshore related parties (of particular concern are arrangements where intangible assets are migrated immediately prior to planned commercialisation)
- involve the use of intangible rights or assets, where the value of these rights and assets is derived from, or maintained by, the activities and operations of Australian entities (in particular the performance of research and development activities)
- dispose of or allocate Australian generated intangible assets to offshore related parties and subsequently grant rights in these assets back to Australian entities.

58. An additional focus of our investigations is the identification of arrangements to which the DPT may have application, particularly whether:

- arrangements with offshore related parties in tax havens or low tax jurisdictions may be characterised as a scheme, which does not meet the sufficient economic substance test for the purposes of the DPT provisions

[12] Diverted Profits Tax
[13] LCG 2017/D7 Diverted Profits Tax

- material information is likely to have been withheld in relation to offshore related parties' use or control of relevant rights or assets, impacting on our ability to assess the relevant arrangement.

59. The risk is being managed through APAs, our risk and audit program and ongoing stakeholder engagement, which includes preparing external guidance for taxpayers and advisors.

Manipulation of thin capitalisation calculations

60. For income years beginning on or after 1 July 2014 the safe harbour debt test thresholds reduced from 75 per cent to 60 per cent for non-authorised deposit taking institution general entities.

61. We anticipated the amount of debt deductions disallowed to increase as a result, however taxpayers have responded to the reduction of the safe harbour thresholds in a variety of ways. One in particular was to increase the value of their total assets by undertaking revaluations of certain assets either for accounting purposes or for thin capitalisation purposes only. This has had the effect of limiting the impacts of the reductions in the safe harbour thresholds. Total 'thin capitalisation only' revaluations made by 151 taxpayers in 2016 totalled $122 billion. This is significant year on year growth: in 2015, revaluations made by 184 taxpayers totalled $56 billion.

62. Currently we are reviewing the thin capitalisation arrangements of 27 taxpayers and are looking to provide assurance on about two-thirds of total revaluations for 2015-16 (approximately $78 billion in revaluations).

63. In addition to asset revaluations, our focus in relation to thin capitalisation includes the:

- inappropriate calculation of debt values for safe harbour calculation purposes
- use of the arm's length debt test
- use of insolvency remote vehicles to avoid thin capitalisation rules.

64. Our risk treatment strategy helps taxpayers correctly apply the law, ensure correct application of accounting standards and review the asset revaluation methodology used.

65. To provide guidance we have published Taxpayer Alerts TA 2016/1[14] and TA 2016/9[15]. In the coming months, we intend to issue a number of guidance products in relation to asset revaluations, the use of the arm's length debt test, as well as other risks observed in the thin capitalisation space.

[14] TA 2016/1 Inappropriate recognition of internally generated intangible assets and revaluation of intangible assets
[15] TA 2016/9 Incorrect calculation of the value of 'debt-capital' treatment wholly or partly as equity for accounting purposes

Country by Country reporting

66. Country by Country (CbC) reporting applies to income years on or after 1 January 2016. Multinationals need to report on their global operations, including income derived and tax paid in each country in which they operate. Australia's legislation requires significant global entities to provide three statements:

    - CbC report – revenue and other information, broken down by tax jurisdiction
    - Master file – information on the global value chain
    - Local file – transactional data that is more extensive than the International Dealings Schedule.

67. We received the first electronic lodgment of a CbC report on 29 September 2017 and analysis is underway.

68. These reports will provide us with an in depth view of a multinational's global structure, operations and economic activity. This will support our strategies to gain confidence in the tax compliance of multinationals.

Table 1: Country by Country lodgments (as at 12 January 2018)

CbC statement type	Number of lodgements received
Short Form Local File	76
Local File Part A	496
Local File Part B	56
Master File	31
CbC Report	5

69. We extended the lodgment due date for 31 December 2017 reporters to 15 February 2018 to provide multinationals extra time to gather relevant information from overseas related parties. Following this February lodgment date, we are expecting a substantial increase in the number of lodgments.

70. A number of guidance products have been developed to support the implementation of CbC reporting. This includes LCG 2015/3[16], guidance on exemptions, the instructions for the local file and guidance for reporting foreign exchange gains and losses in the local file.

[16] LCG 2015/3 Subdivision 815-E of the Income Tax Assessment Act 1997: Country-by-Country reporting

Panama and Paradise papers

71. The Joint International Taskforce on Shared Intelligence and Collaboration (JITSIC), of which Australia is the chair, was used to collaboratively deal with the Panama and Paradise Papers data. The Panama Papers project (which involved 33 of 37 member countries) built tools, structures and collaboratively conducted data analysis to develop a strategy designed to disrupt intermediaries which posed a high risk. This work put the network in a good position to respond to future data leaks, which is now being demonstrated in the actions being taken around the Paradise Paper data leak. This new level of international cooperation has facilitated improved exchange of information and provided an opportunity to pool resources to sharing intelligence, rapidly developing an accurate picture of what the data is telling us.

72. The Mossack Fonseca data (known as the Panama Papers) named 1,386 Australians of which 1,076 were matched to TFNs. Our assessment of the data identified 572 taxpayers as requiring further compliance action.

73. We continue to finalise our compliance action in respect of the Panama Papers with 384 reviews and audits underway or completed. As at 31 December 2017 we have raised over $52 million in liabilities, and collected around $7 million in cash.

74. In relation to the Paradise Papers, we are progressively receiving information from a range of sources, including information from the International Consortium of Investigative Journalists' (ICIJ) website. To date, we have received data, including emails, PDFs, meeting minutes and reports. The data is in both structured and unstructured formats, however most of the information is unstructured. It takes considerable time and effort to analyse and understand the information we receive. Our analysts have started reviewing and indexing the unstructured data and have located the following information relating to Australian taxpayers or Australian activities:

    - international structuring plans involving entities in the e-commerce, energy and resources, and pharmaceutical industries
    - an agenda for an Australian marketing trip undertaken by Appleby in 2013, including planned meetings with specific legal advisors, and corporate entities
    - marketing brochures provided by Appleby in respect of services for intellectual property and online gambling businesses
    - internal Appleby documents setting out their perception of particular jurisdictions and potential structuring opportunities
    - 'handover' notes prepared by Appleby staff prior to commencing annual leave as to the status of their matters.

75. We have developed a master list containing the names of 731 Australian taxpayers and 344 corporate entities, which we are updating as we receive further information. We are sharing the list with the Australian Criminal Intelligence Commission, AUSTRAC and Australian Securities and Investments Commission (ASIC) who are conducting their own analysis of the list

76. We expect that not all the taxpayers identified will have done the wrong thing or may have previously come forward under voluntary disclosure initiatives. However, we will be looking closely at all taxpayers and take firm and decisive action against those we find to be doing the wrong thing.

Hybrid mismatch rules implementation

77. This legislative measure is aimed at multinational companies that exploit differences in the tax treatment of an entity or instrument under the laws of two or more tax jurisdictions. It targets instances of deduction/non-inclusion, double deduction, double non-taxation and deferral. The measure applies broadly to related parties, members of a control group and structured arrangements.

78. The measure is expected to be legislated in 2018 and will apply to payments made six months following the date of Royal Assent to provide taxpayers with sufficient time to review their arrangements and restructure where necessary.

79. Implementation of this measure is expected to result in behavioural change. It will lead multinational groups to adopt more transparent and simpler arrangements that do not give rise to hybrid mismatches. It will also reduce the quantum of debt and other deductions in Australia.

80. We are monitoring multinational enterprises' restructuring in case there is any move towards other aggressive arrangements.

81. The government announced it would also implement the OECD's recommendations on an integrity rule to prevent the use of arrangements attempting to circumvent the hybrid mismatch rules. For example, financing arrangements through the use of interposed entities in zero tax countries. We anticipate this additional measure will also be legislated in 2018.

Monitoring the market

82. We monitor the market through a number of programs including our 'Top 100' program covering our most significant corporate taxpayers and 'Top 1000' program that covers the next 1,000 largest taxpayers. Together these populations represent 54% of the total company income tax reported for 2015-16 and 95 % of the tax payable by the large corporate population.

Pre-lodgement compliance review

83. The pre-lodgment compliance review is focused on the largest 100 taxpayers, who pay approximately 37 per cent of all corporate tax (and 66 per cent of tax paid by large companies).

84. The aim of the pre-lodgment compliance review (PCR) is to assure the right tax outcomes, and identify and manage material tax risks through early, tailored and transparent engagement. PCRs support our approach of raising and resolving potential compliance concerns as they arise – that is, prevention before correction.

85. PCRs have been bolstered through the introduction of the justified trust methodology.

86. PCRs foster a culture of transparency and willing participation through early engagement. They help us build an understanding of a business, including tax governance and preparation processes and decision-making framework, policies, processes and systems.

'Top 1000' multinational and public companies tax performance program

87. This program aims to obtain additional evidence to achieve greater assurance that the largest 1,000 multinational and public companies are paying the right amount of income tax. This supports and expands existing compliance approaches, further enhancing our level of confidence in these taxpayers.

88. Using the justified trust[17] strategy, it extends our regular audit program to review the income tax affairs of taxpayers with a turnover above $250 million outside our 'Top 100' program. This group represents 18 per cent of the total company income tax reported for 2015-16, and 31 per cent of the tax payable by the large company population. Over

[17] Justified Trust

the period of the Tax Avoidance Taskforce, all top 1,000 multinational and public companies will be reviewed.

89. Under the program, specialist tax performance teams engage with each taxpayer using tailored compliance approaches to assure they are paying the right amount of income tax or identify areas of tax risk for follow up.

90. The program focuses on four elements:

- that appropriate tax risk and governance frameworks exist and are applied in practice
- that none of the specific tax risks that we have flagged to the market are present
- the tax outcomes of typical, new or large transactions are appropriate
- any misalignment between tax and accounting results is explainable and appropriate and that the right amount of tax on profit from Australia-linked business is being recognised in Australia.

91. To date, over 120 assurance reviews have commenced with over $104 billion of total business income reported by these taxpayers subject to review. Since 1 July 2017, 19 taxpayers have made voluntary disclosures, with an estimated cash tax impact of over $4 million (bringing the total to over $28 million since the program commenced).

92. We want to provide an even greater level of assurance to the community by ensuring this segment pays the right amount of tax. For companies who work with us to obtain justified trust, the benefits include:

- reduced compliance costs in future years where their arrangements remain largely unchanged
- their Board having confidence in their tax compliance.

Advance pricing arrangements

93. Advance pricing arrangements (APAs) are agreements between us and a taxpayer on the application of the arm's length principle to their dealings with international related parties. They help to manage transfer pricing risk by providing certainty on a prospective basis, using a co-operative approach based on mutual trust to achieve an effective outcome.

94. We currently have 106 APAs in place and 112 in progress. The active APAs cover approximately 10% of total dollar amount of international related party dealings.

Transparency

Taxpayer transparency

Transparency to the public

95. The financial and tax positions of Australian-listed groups are relatively transparent due to the nature of their ownership and governance frameworks. Risks to compliance tend to be around interpretation of tax law and the tax treatment of business transactions. The government has enacted additional reporting requirements for multinationals to increase their transparency.

96. These measures aim to increase large corporate taxpayer transparency to the Australian community:

- voluntary tax transparency code[18]
- corporate tax transparency measure[19]
- general purpose financial statements[20].

97. In addition, some of the largest taxpayers have made public disclosures in relation to significant compliance action by the ATO.

Accountability to the ATO

98. We request tax specific supplements to information already available to us from returns, schedules and public information from taxpayers. Where taxpayers are transparent in their dealings, we can share our view of their group tax risk profile so we can work together to get things right.

99. These specific information requests include:

- country by country reporting[21]
- reportable Tax Positions[22]
- common reporting standard[23]
- exchange of information[24].

[18] Voluntary tax transparency code
[19] Corporate tax transparency measure
[20] General purpose financial statements
[21] Country by country reporting
[22] Reportable Tax Positions
[23] Common reporting standard
[24] Exchange of information

ATO transparency

To the public

100. We have commitments to service in place to assure ourselves and the community that the services we provide are of a consistent and of a high standard. We honour our commitment to transparent management, and accountability for results and client-centred service delivery.

101. The following publications provide transparency of our interactions with large corporates to the Australian community:

- Tax and Corporate Australia[25]
- tax gap[26]
- Annual report segmented settlement data[27].

To large corporate taxpayers

102. One key element of our strategy is to deter taxpayers from entering into arrangements contrary to our view of the law. This has led to a greater emphasis on the use of guidance products, including taxpayer alerts, practical compliance guidelines and law companion guides. Taxpayer alerts, for example, provide an early warning to taxpayers and their advisers of our concerns about new or emerging transactions, structures and arrangements that may represent a compliance risk.

103. We have started to issue Tax Assurance Reports (TAR) to the 'Top 100' and 'Top 1000' public groups and multinational taxpayers. The TAR positively concludes whether we have confidence the taxpayer is paying the right amount of tax according to the law.

104. Read more about our initiatives to increase the transparency of the ATOs views:

- Taxpayer Alerts[28]
- Practical Compliance Guidelines[29]
- Law Companion Guidelines[30]
- Private Rulings[31]
- Early Engagement[32].

[25] Tax and Corporate Australia
[26] Tax gap
[27] Annual report segmented settlement data
[28] Taxpayer Alerts
[29] Practical Compliance Guidelines
[30] Law Companion Guidelines
[31] Private Rulings
[32] Early Engagement

Important information we have published

Tax and Corporate Australia

105. In October 2017 we released Tax and Corporate Australia, a publication about the tax compliance of large corporate groups. It aims to provide the community with assurance that most large corporate groups willingly pay the right amount of tax. It highlights the work we are doing and includes context about the large corporate groups tax gap.

Tax gap

106. At this time we also published the large corporate groups tax gap for 2014-15[33].

107. The tax gap is an estimate of the difference between the amounts we collect and what we would have collected if every taxpayer was fully compliant. The tax gap estimate for 2014–15 is $2.5 billion, or 5.8 per cent of the income tax payable by large corporate groups.

108. Tax gaps exist in all countries to some extent. The gaps are driven by cultural and human factors, global forces and complexity in business and legal systems, those who take aggressive tax positions, and genuine errors.

Settlements

109. Unless a matter has strategic precedential significance, it is a good administrative practice (encouraged by the Courts) to try and resolve factually complex disputes through some form of alternative dispute resolution approach, such as a negotiated settlement.

110. We expect some large matters will be settled every year, with independent scrutineers testing our settlement approaches.

Independent assurance of settlement decisions

111. Three former Federal Court judges have been engaged to provide independent assurance on large and sensitive completed settlements. This independent assurance process tests whether the settlements were a fair and reasonable outcome for the Australian community.

[33] Large Corporate Tax Gap for 2014-15

112. Settlements, with a focus on large corporate groups and multinational enterprises, are selected where the:

- pre-settlement position (tax, penalties and interest) is greater than $50 million
- settled amount is greater than $20 million
- variance amount is greater than $20 million
- settlement is nominated by a senior officer (settlements from significant or sensitive cases, irrespective of size).

113. There have been 11 assurances completed between 1 July 2016 and 31 December 2017, each of which were found to be a fair and reasonable outcome for the Australian community.

114. Six of those were completed in 2016-17, and the remaining five were in the current financial year to 31 December 2017.

ANAO performance audit

115. The Australian National Audit Office (ANAO) conducted a performance audit on the "*Australian Taxation Office's Use of Settlements*".

116. The high level criteria for the audit were – does the ATO:

- enter into, negotiate, and follow up on settlements in accordance with its policies and procedures, including the Code of Settlement?
- have adequate internal guidance and public reporting for settlements?

117. The ANAO audit commenced in May 2017 and the final report was tabled in Parliament in December 2017.

118. Overall, the findings of the report are positive for the ATO, with the report indicating:

- we effectively use settlements and have effective settlement practices
- we have made many improvements to our approach to settlements in recent years (including refreshing the Code of Settlement and introducing the Independent Assurance of Settlements process for large business and multinational enterprises)
- our conformance with settlement procedures and policy was highest in the area of the ATO that deals with large corporate group taxpayers.

119. The ANAO also observed the *Independent Assurance of Settlements* program plays a particularly important role in demonstrating we settle the right cases, including assuring that large corporate group settlements are fair and reasonable outcomes for the

Australian community. The report also identifies we have the highest level of transparency on public reporting around settlements when compared to other international revenue authorities.

120. The ANAO also recommended the ATO:

- review key pre-settlement assurance processes across business lines and implement changes to ensure all business lines have appropriately tailored mechanisms
- implement processes that provide assurance that future compliance terms within settlements deeds are met
- enforce retention of adequate settlement case records and evidence in its Case Management System.

121. The ATO agreed with all the recommendations and suggestions identified by the ANAO.

Improvements in our capability

122. In sustaining workforce capability to meet our corporate tax mandate we have implemented workforce strategies to refresh, build and sustain our technical proficiency.

123. Funding provided by the Government for the Tax Avoidance Taskforce has seen us continue to recruit tax specialists and engage expert consultants to supplement and build our knowledge and expertise while still investing in our graduates as our core base entry recruitment strategy. Our overall staffing has significantly increased since the beginning of the Taskforce in July 2016.

Table 2: Public Groups and International staffing over time

	Assurance, Audit and Enforcement	Risk and Risk Management	Rulings and Advice	Other	Total
December 2017	953	122	132	131	**1,338**
May 2017	932	106	122	125	**1,285**
January 2017	842	103	124	114	**1,183**
August 2016	762	113	138	113	**1,126**
February 2016	789	104	146	94	**1,133**

124. We use our experienced officers and external specialist recruits to provide 'on the job' technical mentoring and broader knowledge sharing. Trends in identifying tax risks in active compliance and advisory work have improved, indicating improvement of collective technical capability (including international tax and transfer pricing knowledge).

125. Our graduates receive orchestrated technical training and are exposed to a variety of supervised work. Their development is focused on a contemporary client engagement program, which covers corporate and line business rationale, builds professional and relationship management skills, provides practical models to understand the large business commercial context as well as efficiently managing case work.

126. ATO results of the 2017 APS Census showed staff working in the Public Groups and International business line had very high satisfaction levels, they indicated:

- the learning and development provided was beneficial to developing skills
- officers were aware of their capability development needs
- officers take responsibility to address these gaps.

Appendix 1 – Compliance activity and year to date results

	Results 2016-17		Results 2017-18 year to date *		Overall results	Ongoing cases
Multinational risk clusters	Taxpayers covered by completed cases	Liabilities raised $m	Taxpayers covered by completed cases	Liabilities raised $m	**Total liabilities raised ($m) from July 2016***	**Active Taxpayers under audit or review**
e-commerce	8	1,222	5	307	1,529	**11**
Lease in lease out	3	33	2	17	50	**6**
Marketing hubs	3	472	2	19	491	**3**
Outbound permanent establishment	0	0	1	12	12	**3**
Pharmaceutical	3	0	3	155	155	**11**
Procurement Hubs	1	20	-	-	20	**2**
Related Party Financing: Arm's Length Conditions	10	1,634	4	323	1,957	**13**
Related Party Financing: Derivatives	2	3	2	13	16	**9**
Related Party Financing: Loan Backs	0	0	1	10	10	**2**
Thin Capitalisation	2	126	2	12	138	**7**
Other Public Group Cases	83	546	52	242	788	**196**
Total	**115**	**4,056**	**74**	**1,110**	**5,166**	**263**

* to 30 November 2017