

**Senate Economics Reference Committee**  
**Inquiry into Corporate Tax Avoidance**  
ANSWERS TO QUESTIONS ON NOTICE

**Australian Taxation Office**

14 MARCH 2018

**Department/Agency: ATO**  
**Question: Hansard Page 64**  
**Topic: Job cuts**

**Question:**

**Senator CAMERON:** In the 2014-15 budget, it was reported that 2,300 jobs would be cut from the tax office. How many of those jobs were cut?

**Mr Hirschhorn:** In terms of exact numbers, I would have to take that on notice. My understanding is that the tax office numbers peaked at about 22,000 and have come down to about 18,000, but I will take the exact numbers on notice.

**Answer:**

From 30 June 2014 to 30 June 2015, the ATO ongoing workforce reduced by 2,669.

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**Department/Agency: ATO**

**Question: Hansard Page 65**

**Topic: Contested Investigations**

**Question:**

**Senator CAMERON:** I've heard that one before, but it's usually has someone else added to the back. You're not saying we are in that situation, are you? Tell me about your clusters.

**Mr Konza:** We have seven taxpayers in the ecommerce area still under action.

**Senator CAMERON:** As you go through, can you give us a figure as to how much is involved in this?

**Mr Konza:** In the ecommerce industry, we have raised \$1 billion worth of assessments and \$800 million have been paid in cash so far. It's fair to say that, of course, we have done the bigger taxpayers first. We have seven still under investigation, but they are not necessarily the bigger ones that have already appeared before this committee. I don't know how much money is actually—

**Senator CAMERON:** Can you take it on notice, for each of the clusters that you take us through, how much is contested? I'm sure that people are saying it's not right. So how much money is in contest—

**Mr Konza:** This will take some work, but we can do it. We have a lease-in, lease-out risk, which is where people lease property from overseas. That sometimes does involve treaty abuse. Marketing hubs—

**Mr Konza:** There are three cases in what we call outbound permanent establishment, which is a very technical description. Again, it is really a matter of treaty abuse and abuse of Australian laws. There are nine pharmaceutical companies. A little while ago as we made progress on ecommerce, we began to move into the pharmaceutical industry. There is one procurement hub case. That's where a company operating in Australia buys everything it needs through an entity that's in an offshore low-tax jurisdiction. There are 13 debt and finance cases. Mr Hirschhorn spoke about how we are using the result of the Chevron decision. There are nine related party financing cases to do with derivatives, so that's another subspecies of that work. There are another two cases of loan backs, which is another subspecies of related party financing. So there are 24 cases in related party financing. Sorry, there's also fit for capitalisation, which is where you can perhaps manipulate how much debt you are allowed to bring to Australia. There are 31 cases in the finance area, so that is obviously a major focus for us.

Then there are 12 cases on what we call intangible migration, which is where people invent valuable intangible assets—such as know-how or industrial technology—here in Australia and then they export it offshore to a low-tax jurisdiction and then actually charge Australia to use its own intellectual property.

**Senator CAMERON:** Are there many more?

**Mr Konza:** No. Then there are other cases which do not appear in any particular cluster. They're the clusters that we are looking at now.

**Senator CAMERON:** On notice, can you give us some more details about what is in contention, where the cases are up to, how much you estimate you will be able to return to government revenue and what steps you are taking to close these loopholes in the future?

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**Answer**

**International Risk Clusters**

The risk cluster strategy is the primary risk management approach that the ATO uses to treat and manage large public multinational entities' risks that exhibit common factors, characteristics or behaviours within a population in a consistent manner.

Each risk cluster develops a strategy that outlines how we detect, deter and prevent these risks in the system, including litigation, communication and capability building strategies.

<b>International risk cluster</b>	<b>Description</b>
E-commerce	<p>This cluster looks at e-commerce industry taxpayers who use arrangements, whereby Australian customers contract with a multinational group in a manner which results in low/no tax being paid on the profits derived from the Australian market.</p> <p>Focus areas include: Permanent establishment existence, the avoidance of royalty withholding tax, profit attribution at non-arm's length rates and risks associated with the cloud computing industry generally.</p>
Lease in lease out	<p>Cross-border leasing arrangements involving mobile assets (such as ships or drilling platforms) under which multinational enterprises bring assets into Australia for commercial purposes. Our concerns primarily relate to the application of the transfer pricing and permanent establishment attribution rules and whether the amount brought to tax is consistent with the contribution made by the Australian operations and the use of the mobile asset in the leasing arrangements adopted (some companies are acknowledging the presence of a permanent establishment but then inappropriately attributing minimal profit to the permanent establishment).</p> <p>We are also concerned with the application of provisions in relation to withholding tax, the tax liability of certain foreign lessors involved in the leasing arrangement, and the general anti-avoidance rules in Part IVA.</p>

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International risk cluster	Description
Marketing Hubs	<p>The marketing hubs cluster looks at multinationals utilising offshore marketing hubs to sell physical goods. Key risks within this cluster include:</p> <ul style="list-style-type: none"> <li>• The economic substance of offshore marketing hub arrangements being materially different to the legal form or not reflecting arm's length conditions</li> <li>• the use of a transfer price which does not reflect the functions performed, assets used and risks assumed of the various parties involved in the arrangement.</li> </ul>
Outbound Permanent Establishment (PE)	<p>The Outbound PE Cluster is looking at arrangements involving Australian income tax consolidated groups with subsidiaries using offshore permanent establishments. These subsidiaries (via their offshore PEs) enter into intra-group transactions with other members of the income tax consolidated group. The intra-group transactions are ignored for Australian income tax purposes (consolidation single entity rule). However, they are recognised in the offshore tax regime thereby creating hybrid asymmetry.</p>
Pharmaceuticals	<p>The pharmaceuticals cluster looks at the pricing used by multinational pharmaceutical companies for imported ethical drugs and medical devices. The principal identified risk is that prices paid for imported pharmaceuticals from related parties are not at arm's length.</p>
Procurement Hubs	<p>The Procurement Hubs cluster looks at Australian multinationals establishing offshore procurement hubs to source and supply goods and services. Our concerns about these arrangements relate primarily to the controlled foreign company (CFC) rules, transfer pricing rules and Part IVA.</p> <p>The risk is present due to a number of factors, including but not limited to:</p> <ul style="list-style-type: none"> <li>• charging a higher margin/return</li> <li>• business restructures resulting in shifting of functions, assets and risks with the consideration paid not on arm's length terms</li> <li>• the use of a bifurcated procurement hub, resulting in profits offshore falling outside of the CFC attribution rules.</li> </ul>

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<b>International risk cluster</b>	<b>Description</b>
Related Party Financing: Arm's Length Conditions	Overseas related party financing risk with respect to related party borrowing (or other debt issue) generating deductible interest that significantly exceeds the commercial funding cost of the multinational parent entity (who could have otherwise funded the Australian entity).
Related Party Financing: Derivatives	The Related Party Derivatives Cluster is reviewing related party derivatives used by taxpayers to: <ul style="list-style-type: none"><li>• inflate deductions for related party financing costs</li><li>• avoid withholding tax.</li></ul>
Related Party Financing: Loan Backs	The Loan Backs cluster is focused on cross border financing arrangements, where the arrangement consists of circular intra-group transactions to generate a tax benefit or preferential tax treatment.
Thin Capitalisation	This cluster focuses on various risks associated with the thin capitalisation rules including: <ul style="list-style-type: none"><li>• taxpayers increasing their debt capacity under the thin capitalisation rules by utilising inappropriate asset revaluations</li><li>• the incorrect application of the thin capitalisation rules to achieve a higher safe harbour level</li><li>• the application of the arm's length debt test under the thin capitalisation rules.</li></ul>
Intangible Migration	The Intangibles Migration cluster manages risks arising from the dynamic migration or artificial allocation of intangible assets, and rights in those assets, to offshore related parties by multinational enterprises. These arrangements could result in royalty payments being made to the offshore related party that would reduce the amount of tax payable by the Australian entity.

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**Compliance Risk Program (as at end February 2018)**

We have 73 taxpayers in an international risk cluster under active audit or review which haven't yet reached the stage of issuing an amended assessment. The table below provides a break up.

<b>Multinational Risks</b>	<b>Active taxpayers in cluster under audit or review</b>
E-commerce	7
Lease in lease out	4
Marketing Hubs	3
Outbound Permanent Establishment	3
Pharmaceuticals	8
Procurement Hubs	1
Related Party Financing: Arm's Length Conditions	15
Related Party Financing: Derivatives	9
Related Party Financing: Loan backs	2
Thin Capitalisation	7
Intangibles Migration	14
<b>Total</b>	<b>73</b>

Due to the ongoing nature of our case work, we are unable to provide expected revenue collections for the above international risk clusters. Such estimates would only be speculative in nature.

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**Closing tax loopholes**

As well as ongoing discussions with the Treasury, we are using taxpayer alerts and practical compliance guidelines to provide more certainty to multinationals and public groups.

To date we have issued the following taxpayers alerts and practical compliance guidelines.

<b>Taxpayer Alerts (TA) issued to provide an early warning of ATO concerns about new or emerging transactions, structures or arrangements that may represent a compliance risk</b>	
Lease in Lease out	<ul style="list-style-type: none"><li>• TA 2016/4: Cross Border leasing arrangements (Apr 2016)</li></ul>
Multinational Anti-Avoidance Law (MAAL)	<ul style="list-style-type: none"><li>• TA 2016/2: Interim arrangements in response to the MAAL (Apr 2016)</li><li>• TA 2016/8: GST implications of arrangements entered into in response to the MAAL (Aug 2016)</li><li>• TA 2016/11: Restructures in response to the MAAL involving foreign partnerships (Sept 2016)</li></ul>
Outbound Permanent Establishment	<ul style="list-style-type: none"><li>• TA 2016/7: Offshore permanent establishments (Aug 2016)</li></ul>
Procurement Hubs	<ul style="list-style-type: none"><li>• TA 2015/5: Arrangements involving offshore procurement hubs (Dec 2015)</li></ul>
Related Party Financing: Derivatives	<ul style="list-style-type: none"><li>• TA 2016/3: Related party foreign currency denominated finance with related party cross currency interest rate swaps (Apr 2016)</li></ul>
Related Party Finance: Loan Backs	<ul style="list-style-type: none"><li>• TA 2016/10: Cross-border round robin financing arrangements (Sep 2016)</li></ul>

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<b>Taxpayer Alerts (TA) issued to provide an early warning of ATO concerns about new or emerging transactions, structures or arrangements that may represent a compliance risk</b>	
Research and Development Tax Incentive	<ul style="list-style-type: none"> <li>• TA 2017/2: Claiming the R&amp;D Tax Incentive for construction activities (Feb 2017)</li> <li>• TA 2017/3: Claiming the R&amp;D Tax Incentive for ordinary business activities (Feb 2017)</li> <li>• TA 2017/4: Claiming the R&amp;D Tax Incentive for agricultural activities (Feb 2017)</li> <li>• TA 2017/5/5A: Claiming the R&amp;D Incentive for software development activities (Feb 2017)</li> </ul>
Stapled Structures	<ul style="list-style-type: none"> <li>• TA 2017/1: Re-characterisation of income from trading businesses (Jan 2017)</li> </ul>
Thin Capitalisation	<ul style="list-style-type: none"> <li>• TA 2016/1: Inappropriate recognition of internally generated intangible assets and revaluation of intangible assets (Apr 2016)</li> <li>• TA 2016/9: Incorrect calculation of the value of ‘debt-capital’ treatment wholly or partly as equity for accounting purposes (Aug 2016)</li> </ul>

<b>Practical Compliance Guidelines (PCGs) issued to provide broad law administration guidance, address the practical implications of tax laws and outline the ATO’s administrative approach</b>	
Division 7A	<ul style="list-style-type: none"> <li>• PCG 2017/13: Division 7A – unpaid present entitlements under sub-trust arrangements maturing in the 2017 or 2018 income years (July 2017)</li> </ul>
Fixed entitlements and fixed trusts	<ul style="list-style-type: none"> <li>• PCG 2016/16: Fixed entitlements and fixed trusts (finalised 13 September 2017)</li> </ul>
Marketing Hubs	<ul style="list-style-type: none"> <li>• PCG 2017/1: Practical compliance guidelines for offshore hubs (Jan 2017)</li> </ul>

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**Tackling tax avoidance**

The Tax Avoidance Taskforce was established on 1 July 2016 to increase existing efforts targeted at ensuring multinational enterprises, and large public and private groups (and associated individuals) operating in Australia, pay the right amount of tax in Australia.

Our work in these areas has been bolstered by the introduction of several new laws.

**Multinational anti avoidance law**

Many taxpayers are actively considering their positions and transitioning to compliant and commercially realistic tax structures in response to the multinational anti-avoidance law (MAAL). At 31 January 2018, 38 companies had restructured, which resulted in the return of more than \$7 billion in sales to the Australian tax base.

**Diverted profits tax**

The diverted profits tax applies from 1 July 2017. It ensures the tax paid by significant global entities properly reflects the economic substance of their activities in Australia, and prevents diverting profits offshore. It also encourages these entities to provide enough information to resolve tax disputes in a timely manner. We are looking at those companies that may find themselves subject to the diverted profits tax and are actively engaging with them to ensure there is no delay and ambiguity regarding our expectations.

**Other new laws include:**

- Increased administrative penalties for significant global entities
- Tightening of thin capitalisation rules to stop excessive debt deductions
- Strengthened transfer pricing rules to align with OECD guidance

**New intelligence sources**

We have also introduced stronger compliance measures, including new intelligence sources such as country-by-country reporting and common reporting standards, which are helping us to monitor and assure the tax performance of public and multinational businesses.

Country-by-country reporting obligations apply to income years starting on or after 1 January 2016 and require multinationals to report on their global operations including income derived and tax paid in each country in which they operate.

The common reporting standard is the single global standard for the collection, reporting and exchange of financial account information on foreign tax residents. Under the provisions, financial institutions will collect and report to the ATO financial account information on non-

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residents. The ATO will exchange this information with participating foreign tax authorities. The ATO will receive financial account information on Australian residents from other countries' tax authorities. This will help ensure that Australian residents are complying with Australian tax law and act as a deterrent to tax evasion. The measure took effect from 1 July 2017.

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**Department/Agency: ATO**

**Question: Hansard Page 68**

**Topic: Staff dedicated to review companies**

**Question:**

**CHAIR (Ketter):** How many staff are dedicated to investigating deductions claimed by resource companies like Exxon?

**Mr Hirschhorn:** Again, we don't cut our workforce that way, by industry. I'll give you a rough number, but we can get you the precise numbers on notice. We have more than 1,300 people in the public business and international groups who are fully focused on large corporations. They are supported by people in our Tax Counsel Network, our review and dispute resolution area and whatnot around large companies. As a resource-commodity economy, with some of our biggest companies being in the resources industry, a fair percentage of our people are focused on resource companies, but we don't really track it—with the exception of something like the petroleum resource rent tax, where I have a team which focuses on the petroleum resource tax. When it comes to corporate tax, I don't have teams which do just resource taxation. Before my time, the organisation did allocate large business in that way, and it was found, I think, not to be the ideal way of managing your capability because it did create different silos and divergences in practice.

**Answer:**

Refer to Advance QoN ExxonMobil received Tuesday 13 March 2018.

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**Department/Agency: ATO**  
**Question: Hansard Page 69**  
**Topic: Top 100 group**

**Question:**

**Mr Hirschhorn:** Yes. The top 100 companies will all have a dedicated team who have responsibility for that company all the time. If they find something that they want to look at more, they might work on it or, indeed, other people might be brought in to help them, depending on the issue.

**CHAIR (Ketter):** How many are in that top 100 group?

**Mr Hirschhorn:** I'll take on notice how many people we have—our rough split of work between the top 100. But the top 100 pay half of all corporate tax and two-thirds of all large-market tax, so as a rule of thumb you could say that it's probably pretty proportionate.

**Mr Konza:** If you look at our teams, our teams consist of up to a dozen people. They might have a couple of large companies; they might have a few slightly smaller companies. We put a workload together, balancing different things to add up to a hundred per cent for them. That's why, when you ask those sorts of questions, we have to actually split apart our data to identify the answers.

**Mr Hirschhorn:** We'll do our best but it will be rough proportions, because we don't allocate specific teams to large corporate resource industry audits versus banking reviews et cetera. Our team is much more flexible than that.

**Answer:**

<b>FTE estimates working on Top 100 taxpayers – 2017-18 (as at 5/4/18)</b>		
	<b>FTE</b>	<b>Cost</b>
PG&I Operations	222	\$26,746,782
PG&I Other*	286	\$34,457,566
RDR	23	\$2,771,063
TCN	48	\$5,783,088
Smarter Data	22	\$2,650,582
<b>Total</b>	<b>601</b>	<b>\$72,409,081</b>

\*Other includes: estimates of time spent on top 100 issues by other areas in PG&I, for example specialist areas such as economist practice, law advice and resolution, advice and guidance, specialist risk management teams and generalist areas providing overall support.

The figures above have been compiled based on proportional estimates and are indicative only. PG&I Operations figures are as advised by Operational compliance teams and represent estimated staff effort working directly on assurance and compliance issues with the top 100.