

# Chapter 1

## Background to the inquiry

1.1 On 2 October 2014, the Senate referred the matter of corporate tax avoidance and aggressive minimisation to the Economics References Committee for inquiry and report by the first sitting day of June 2015.<sup>1</sup> On 16 June 2015, the reporting date for the inquiry was extended to 13 August 2015. On 10 August 2015, the reporting date for the inquiry was further extended to 30 November 2015.

1.2 The terms of reference for the inquiry are:

Tax avoidance and aggressive minimisation by corporations registered in Australia and multinational corporations operating in Australia, with specific reference to:

- (a) the adequacy of Australia's current laws;
- (b) any need for greater transparency to deter tax avoidance and provide assurance that all companies are complying fully with Australia's tax laws;
- (c) the broader economic impacts of this behaviour, beyond the direct effect on government revenue;
- (d) the opportunities to collaborate internationally and/or act unilaterally to address the problem;
- (e) the performance and capability of the Australian Taxation Office (ATO) to investigate and launch litigation, in the wake of drastic budget cuts to staffing numbers;
- (f) the role and performance of the Australian Securities and Investments Commission in working with corporations and supporting the ATO to protect public revenue;
- (g) any relevant recommendations or issues arising from the Government's White Paper process on the 'Reform of Australia's Tax System'; and
- (h) any other related matters.<sup>2</sup>

1.3 Given the broad scope of the inquiry and the variety of aspects to consider, the committee resolved to release an interim report on the evidence that was received following the initial request for submissions and presented at the hearings in April 2015.

1.4 The committee is continuing to investigate a number of matters in relation to the operations and structure of multinationals that were not part of the initial consultation process. A final report will be released following the conclusion of these investigations.

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1 *Journals of the Senate*, No. 59, 2 October 2014, p. 1588.

2 *Journals of the Senate*, No. 59, 2 October 2014, p. 1588.

## **Conduct of inquiry**

1.5 The committee advertised the inquiry on its website and in the *Australian*. The committee also wrote directly to government agencies, large corporations based in Australia and multinationals operating in Australia, industry groups and associations, academics and other interested parties drawing attention to the inquiry and inviting them to make submissions.

## **Submissions and public hearings**

1.6 The committee received 121 submissions, including 3 confidential submissions. The submissions and questions on notice are listed at Appendix 1.

1.7 To date, the committee has held six public hearings:

- 8 April 2015 in Sydney;
- 9 April 2015 in Canberra;
- 10 April 2015 in Melbourne;
- 22 April 2015 in Sydney;
- 1 July 2015 in Sydney; and
- 4 August 2015 in Melbourne.

1.8 A list of witnesses is provided at Appendix 2. References to the Committee Hansard are to the Proof Hansard and page numbers may vary between the Proof and Final Hansard transcripts.

1.9 The committee thanks all the individuals and organisations who assisted with the inquiry, especially those who made written submissions and appeared at hearings.

## **Background to inquiry**

1.10 The matter of corporate tax was referred to the committee because of widespread concerns about the nature and prevalence of tax avoidance and aggressive tax minimisation among large Australian corporations and multinational enterprises operating in Australia.

1.11 Internationally, the Organisation for Economic Co-operation and Development (OECD) is concerned that many multinational companies are legally able to plan their tax affairs to reduce significantly, if not eliminate, their tax liabilities. It understands that:

Global solutions are needed to ensure that tax systems do not unduly favour multinational enterprises, leaving citizens and small business with bigger tax bills.<sup>3</sup>

1.12 In response, the Group of 20 (G20) and OECD, together with other willing countries, have been developing a series of measures which aim to put an end to

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3 *OECD urges stronger international co-operation on corporate tax*, 12 February 2013, <http://www.oecd.org/ctp/oecd-urges-stronger-international-co-operation-on-corporate-tax.htm> (accessed 30 July 2015).

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aggressive tax planning and fix loopholes that currently exist in the international tax framework.<sup>4</sup>

1.13 It has also been recognised domestically that there are opportunities within the tax system for multinationals to minimise the tax burden in Australia. In an address to the World Economic Forum, the Prime Minister identified the need for action:

A more global economy with stronger cross-border investment eventually helps everyone because it generates more wealth and ultimately creates more jobs.

Of course, money's tendency to flow to where taxes are lowest is a powerful incentive for all countries to keep taxes down.

One of the side effects of globalisation is more ability to take advantage of different country's tax regimes.

Different national tax arrangements have not always kept up with the rise of services and the pervasiveness of digital technologies.

So, the G20 will continue to tackle businesses artificially generating profits to chase tax opportunities rather than market ones.

The essential principle is that you should normally pay tax in the country where you've earned the revenue.<sup>5</sup>

1.14 While successive governments have sought to address the deficiencies in the tax system, the matter was again brought to the fore in October 2014 by the Tax Justice Network Australia. The report, *Who Pays for Our Common Wealth?*, asserted that many of the largest public corporations (as listed on the ASX 200) do not pay their 'fair share' of corporate tax and have subsidiaries operating in jurisdictions considered to be 'tax havens'.<sup>6</sup>

1.15 The Tax Justice Network Australia report reignited the corporate tax debate and led to a number of media reports exploring and highlighting the extent to which some Australian companies and multinationals operating in Australia were using aggressive tax planning to reduce their Australian tax obligations.<sup>7</sup> This further contributed to concerns within the community that large corporations were not paying their 'fair share' of tax.

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4 *Committee Hansard*, 9 April 2015, p. 59.

5 The Honourable Tony Abbott MP, *This Year's G20: Getting the Fundamentals Right*, Address to the World Economic Forum, Davos Switzerland, 23 January 2014.

6 Tax Justice Network—Australia, *Who Pays for Our Common Wealth*, October 2014.

7 See, for example, Health Aston and Georgia Wilkins, 'ASX 200 company tax avoidance bleeds Commonwealth coffers of billions a year, report finds', *Sydney Morning Herald*, 29 September 2014; and 'Tax Justice Network report reveals tax burden shifting from companies to ordinary taxpayers', [www.news.com.au](http://www.news.com.au), 29 September 2014.

### ***Defining tax avoidance and aggressive minimisation***

1.16 Noting that definition of certain terms may differ, it is necessary to define tax minimisation, tax avoidance and tax evasion for the purposes of this report. In the words of Mr Martin Lock:

Corporate tax avoidance is difficult to define. However, without defining it, it can't be identified, measured or addressed.<sup>8</sup>

1.17 Tax minimisation, tax avoidance and tax evasion can be considered along a spectrum of activity, where tax minimisation and tax evasion sit on either end with a large 'grey' area in between representing aggressive tax minimisation and tax avoidance.

1.18 Tax minimisation, or tax planning, is a legal activity permitted under the income tax framework which allows corporations to reduce their tax obligations. Tax planning is legitimate when it is done within the letter of the law.

1.19 By contrast, tax evasion is an illegal activity whereby corporations deliberately and intentionally mislead tax authorities in order to reduce tax obligations.

1.20 Aggressive tax minimisation, or aggressive tax planning, encompasses schemes that push the boundaries of what is considered to be acceptable. For example, aggressive schemes may include claiming excessive deductions (such as interest related to debt loading) or complex financing arrangements that may facilitate avoidance of tax obligations.

1.21 Similarly, tax avoidance refers to activities that sit on the edge of being legal and require investigation (and possibly litigation) to determine whether they are within the law. Australia has general anti-avoidance rules (GAAR) which seek to impose tax obligations on tax avoidance schemes that are wholly or predominantly undertaken to receive a tax benefit.<sup>9</sup>

1.22 Indeed, the legality of this grey area is somewhat indeterminate as some schemes associated with aggressive minimisation and avoidance are yet to be investigated, potentially challenged and ruled on by tax authorities and courts. Such considerations about legality are further complicated by the fact that most schemes are unique and tailored to individual business circumstances. As such, a dedicated evaluation process by tax authorities is often required to determine if aggressive minimisation and avoidance schemes are legitimate.

### **Scope of this inquiry**

1.23 The committee appreciates that Australia's corporate tax system is complex and it often takes many years to become an experienced practitioner. As such, it is

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8 *Submission 56*, p. 3.

9 General anti-avoidance provisions are outlined in Part IVA of the *Income Tax Assessment Act 1936*.

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beyond the scope of this inquiry to consider specific technicalities of the corporate tax regime and/or its interpretation.

1.24 That said, there appears to be a number of aspects of Australia's corporate tax system that allows some corporations to reduce or even eliminate their Australian tax obligations in a way that was not intended by the parliament when the law was enacted.

1.25 Reflecting these concerns and multi-dimensional nature of corporate tax concerns, this inquiry explores:

- the importance of corporate income tax to Australia's revenue base;
- the effect of tax avoidance and minimisation activities on the integrity of the tax system, and society more broadly;
- the challenges facing the sustainability of the corporate income tax base;
- opportunities to strengthen the integrity of the corporate tax system and address risks to its sustainability;
- progress on implementing actions identified by the G20 initiative on BEPS and associated plans;
- the potential for Australia to take unilateral action to address risks to the corporate income tax base; and
- the efficiency and effectiveness of the Australian Taxation Office to identify and enforce attempts to thwart corporate income tax responsibilities.

1.26 The committee notes that a number of stakeholders commented on the tax avoidance activities of Australian multinationals in the context of developing countries.<sup>10</sup> However, it considers that this issue was outside the scope of the inquiry's terms of reference which was looking at tax avoidance in Australia. Where appropriate, this issue may be within scope of the inquiry into foreign bribery.

### **Structure of this report**

1.27 This interim report comprises six chapters.

- Chapter 1—provides background to the inquiry.
- Chapter 2—provides a broad overview of corporate income tax in Australia.
- Chapter 3—identifies various risks and challenges to the integrity of the corporate income tax base.
- Chapter 4—examines the work of the OECD to develop a coordinated approach to address issues associated with base erosion and profit shifting.
- Chapter 5—explores opportunities for Australia to take unilateral action to close some existing problems with the corporate tax regime that are outside

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10 See, for example, Publish What You Pay, *Submission 30*; ActionAid Australia, *Submission 67*; and Uniting Church of Australia, Synod of Victoria and Tasmania, *Submission 74*.

the OECD remit and considers unilateral options in circumstances where the OECD work does lead to the intended outcome.

- Chapter 6—reviews the performance and capabilities of the ATO and the role of the Australian Securities and Investments Commission (ASIC) in sharing information relevant to identifying corporate tax avoidance.