Chapter 2
A persistent problem

Introduction

2.1 This inquiry has highlighted a number of the aggressive tax practices employed by foreign based multinationals operating in Australia. They include avoidance of permanent establishment, excessive debt loading, aggressive transfer pricing, and the use of tax havens. Such practices appear in almost all industries but seem to be most prevalent and egregious where there is significant intellectual property embodied in the value of the good or service, such as pharmaceuticals and activities relating to the digital economy.

2.2 It is clear to the committee that the public is understandably sceptical when the Australian subsidiaries of some prominent multinationals pay such small amounts of corporate income tax, and in some cases no tax at all, on revenue from activities in Australia.[1] The committee was told, for example, that Apple Australia paid around $80 million in income tax on revenues of over $6 billion in 2013-14.[2] Aggressive tax minimisation practices deprive Australia of substantial amounts of tax revenue that should rightly be available to pay for public services. This behaviour risks eroding public confidence in Australia's tax system.

2.3 The committee considers that the tax burden should be shared equitably between business and individuals, and that everyone should be (and be seen to be) contributing their 'fair share'. However, the evidence presented to the inquiry indicates that there is a disparity between the contributions of individuals and local firms, and large multinational companies, many of which have Australian subsidiaries that have engaged in, and continue to carry on, large scale tax minimisation practices in Australia.

2.4 When asked about tax avoidance and aggressive tax minimisation, the multinationals in question justify such activities by arguing that these practices are consistent with the laws in each jurisdiction in which they operate and that they are paying the taxes calculated by the tax office. At issue is not the legality of the activities of multinationals, but whether their conduct aligns with the intention and spirit of the existing legal framework, and meets the expectations of the public. The central concern is to what extent multinationals arrange their corporate structure and engage in practices deliberately intended to deny Australia its proper share of tax and whether they are held accountable for engaging in such practices.

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1 The committee understands that corporate tax is levied on profits not revenue but the fact that these companies are allowed to book profits margins that are so low is a concern to the committee and the community more broadly.

2 Mr Tony King, *Committee Hansard*, 8 April 2015, p. 46.

Increasing transparency remains pivotal

2.5 A consistent theme throughout this inquiry has been the lack of public information about company tax affairs and an unwillingness of certain companies to divulge this information. For example, a number of companies attended hearings for the inquiry but could not, or would not, provide even basic tax information to the committee about their Australian operations.

That is not the question

2.6 Throughout the inquiry process, the committee experienced witnesses that consistently sought to avoid answering the questions posed. In order to convey the difficulties the committee experienced in trying to draw out relevant answers from witnesses, the committee is of the view that the transcript of the following exchange between officers of Sanofi Australia and the committee should be reproduced in full. The committee was trying to establish how the cost of a product purchased by an Australian subsidiary from another subsidiary was determined:

> CHAIR: There is something here—I think I may have misheard, so I just want to check I am correct about this: you are saying the price you pay is regardless of where the product is sourced from.
>
> Mr McAllister: Correct.
>
> CHAIR: Then how can that be at arm's length? Surely, an arm's-length price should vary based on the cost of production. If it does not vary based on the cost of production, then what is the variation based on?
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> Mr McAllister: We are receiving the remuneration as the distributor. We are bringing in finished goods products within pharma. It is a different story for, obviously, consumers but we make them here. We are playing the role as a local distributor. If we were to look at a third party to take on the same role, activity and bear the same risk as a local distributor, it would be the same amount.
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> CHAIR: Mr McAllister, that is not the question I asked. I asked—and I will probably reword it: you are saying you pay the same regardless of where it is sourced from. At the same time, you are saying these are independent arm's length agreements. I cannot reconcile how: if the price you are paying is not based on the cost of your Singapore company to produce the drug—they are not producing it; it is being produced in Germany or wherever. Some is being produced in Bangladesh, some is being produced in India—it is a global drug market. But if it is not being based on the cost of production, what is it being based on?
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> Mr McAllister: I believe the product we are talking about is actually mostly produced in Germany. So it is not like there are lots of different cost of good structures around that product.
>
> CHAIR: But you made the point—and these are your words, not mine—that the cost of production, regardless of where it is sourced from, does not change the price. My question is, and this is the fundamental question: why?
>
> Senator MILNE: Exactly. Why doesn't it?

> Mr McAllister: We are being compensated locally as the distributor for the risks we bear here.
>
> CHAIR: I accept that. That is a matter of fact. The question is not what is happening but why.
>
> Ms Vitalis: What I mean is that we have our costs that remunerate the risks that we take in the country as distributor. What we consider to have margin in the country is the margin that we get as a local distributor of the group products.
>
> CHAIR: That is not the question. Let us go back and see what the question is. You are purchasing these drugs from a related party from Singapore—most of your drugs. There are some drugs that you get from elsewhere, but most of your drugs—and we are generalising here—are being purchased from Sanofi Singapore, which is the regional hub for Sanofi international, Sanofi France or whatever your parent company is called. Correct?
>
> Mr McAllister: Sure.
>
> CHAIR: You are saying that the agreement you have for the drugs that you are paying for is an independent arrangement at a fair price. Correct?
>
> Mr McAllister: Yes.
>
> Ms Vitalis: Yes.
>
> CHAIR: You are also saying that the price that you pay does not vary based on where it is sourced from, which makes me ask the question: why? If it is not based on the cost of production, what is this agreement based on?
>
> Mr McAllister: Obviously, there is nothing inappropriate being done here. We are working within the established principles of the OECD and the Australian tax rules—
>
> CHAIR: Mr McAllister, that was not the question. You know what the question is; you are just not answering it. Why?[3]

2.7 It is understandable that in the face of this resistance to answer questions, the committee holds concerns about the lack of cooperation from multinationals and how this reflects more broadly on their conduct in Australia and their attitude to Australia's tax laws.

Corporate structure

2.8 The committee found similar evasiveness when trying to elicit information on the complex corporate structure of multinationals and the reasons behind this type of arrangement. It was trying to understand to what extent tax regimes influenced the activities and location of the parent company and its numerous subsidiaries. However, the responses were clearly designed to obscure; unfortunately, this obfuscation was commonplace.

2.9 Pfizer provided a good example of both the convoluted corporate structure with its complex web of interrelated companies and the inability of the Australian

3 *Committee Hansard*, 1 July 2015, pp. 32-33.

executives to explain the relevance or significance of the structure or to offer any coherent explanation for that structure:

> Mr George: …The Australian holding company is a company in Australia, Pfizer Australia Holdings Pty Ltd. The two companies in the Netherlands are called Pfizer Global Holdings BV and Pfizer Australia Holdings BV. The fact it is a BV means it is a Netherlands company…
>
> Senator EDWARDS: Do they own separate classes of shares? Are they equal shareholders? How is the shareholding of Pfizer Australia held?
>
> Mr George: They all own ordinary shares so they all have an equal class of share. The two Netherlands entities own 45 per cent each and the Luxembourg company owns 10 per cent.
>
> CHAIR: What is the Luxembourg company called?
>
> Mr George: Pfizer Shareholdings Intermediate SARL.
>
> Senator EDWARDS: Why have you structured it that way?
>
> Mr Gallagher: That is the corporate structure which our holding company falls into.
>
> Senator EDWARDS: No; I get that—and that is the third time you have done that. Why have you structured it that 45 per cent are in those two companies, and why is there a Luxembourg one with a 10 per cent shareholding? Do not say to me, 'That is the corporate structure', because that is implicit.[4]

2.10 The deliberate structuring of business activities to minimise tax obligations has resulted in colloquial naming of some of the more prevalent examples. For instance, reference was made to a 'Singapore sling' where marketing hubs are set up in Singapore to take advantage of relatively low company tax rates and preferential tax agreements whereby multinationals are given incentives to locate their activities in that jurisdiction.

2.11 Similarly, a 'double Irish with Dutch sandwich' allowed multinationals, until recently, to establish a series of companies in both Ireland and the Netherlands to reduce their tax liabilities. Associate Professor Antony Ting indicated that this arrangement has allowed Apple to avoid paying tax:

> From Australia's perspective, when Apple's Australian subsidiary sells an iPad for $600 to a customer in this country, it is estimated that about $550 (that is, approximately 90%) is shifted to Ireland. To make it worse, out of this $550, about $220 (that is, approximately 36%) is never taxed anywhere in the world. This is called 'double non-taxation' in the tax world.[5]

2.12 The committee found it incredulous that the CEO of Apple Australia did not know what a 'double Irish sandwich with Dutch associations' was:

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4 *Committee Hansard*, 2 July 2016, pp. 8-9.

5 *Submission 22*, p. 2.

> Mr King: What I can say is that we book all of our revenue and sales that we do in Australia in our books locally, we book all of the costs associated with doing business here, we buy our products from affiliate companies within the Apple group and we pay all of our taxes on our sales here in Australia.
>
> Senator MILNE: No doubt—that is what you are saying. I asked you about the allegation that Professor Ting made in his submission, which is that basically you have an international tax avoidance structure—'a double Irish sandwich with Dutch associations'. What is a double Irish sandwich with Dutch affiliations?
>
> Mr King: I have no idea what you are talking about.
>
> Senator MILNE: Oh come on, you have not come here today to say that!
>
> Mr King: What I can say is that all of our revenue is recorded in our books here, all of our costs of doing business are reported in our books and we buy products from affiliate companies outside of Australia.
>
> Senator MILNE: So why does this money go straight to Ireland and then through the Netherlands and then back to Ireland? What is going on with that?
>
> Mr King: All of our business here is clearly reported in our books.
>
> Senator MILNE: I am not asking what you are reporting. I am asking you about this arrangement that you have.
>
> Mr King: The arrangement that we have is very clear in the business that we do in Australia. All the revenue and all of the costs of doing business are clearly reported in our books here in the Australian market.[6]

2.13 Clearly, tax minimisation was a major driver in locating a company's headquarters and distribution hubs in low tax jurisdictions. But much to the committee's chagrin, the companies would not broach the subject. In some cases, the answers to questions stretched beyond credibility. For example, Airbnb (a US company) ventured that it set up its international office in Ireland principally to access talent:

> Mr McDonagh: We closed some of those offices because one of our core values at Airbnb is to simplify. It just was not effective to have all of those offices and all of those people.
>
> Senator EDWARDS: Why Ireland?
>
> Mr McDonagh: I think Ireland is important for a number of reasons.
>
> Senator EDWARDS: What is the No. 1 reason?
>
> Mr McDonagh: I would say that the No. 1 reason we located ourselves in Ireland was for access to great talent.
>
> Senator EDWARDS: Come on!

6 *Committee Hansard*, 8 April 2015, p. 47.

> Mr McDonagh: It is generally the head of our global operations.
>
> Senator DI NATALE: And the corporate tax rate in Ireland had nothing to do with it?
>
> Mr McDonagh: We do not make any long-term decisions for the business based on tax rates.[7]

2.14 Compared with the Australian corporate tax rate of 30 per cent, the corporate tax rate in Ireland is 12.5 per cent but can be much lower, if not eliminated, through the use of structures like the 'double Irish Dutch sandwich'.

2.15 The audacity of certain multinationals in refusing to comply with legitimate and reasonable requests for information raises suspicions that they have something to hide. The unwillingness of many multinationals to discuss openly their tax arrangements underscores the need to establish mechanisms to increase transparency.

Special purpose accounts

2.16 The public accessibility of important company information is another area where multinationals operating in Australia can avoid scrutiny. Australian accounting standards allow those for-profit entities that do not classify themselves as reporting entities to prepare special purpose financial reports. In the context of this inquiry, general purpose financial reports provide information on corporate tax and related party transactions, whereas special purpose financial reports need not provide this information.[8]

2.17 Based on research conducted by the Australian Accounting Standards Board (AASB), around 80 per cent of large proprietary companies, including most unlisted multinational corporations operating in Australia, were preparing special purpose financial reports during the period 2008 to 2011. According to the CEO of the AASB:

> All things being equal, we would think that would be on the high side.[9]

2.18 The AASB has recognised that there is a potential problem with the reporting entity concept and has engaged with regulators and policymakers to develop objective criteria to determine which entities should be required to prepare and lodge financial statements and what those financial reporting requirements should be. The CEO of the AASB considered that:

> …the reporting entity concept should be applied by the regulators to work out what some objective criteria are. Hopefully, that will simplify the whole process. So it should be quite simple: if you meet certain criteria, you know

7 *Committee Hansard*, 18 November 2016, p. 57.

8 Ms Kris Peach, Australian Accounting Standards Board, *Committee Hansard*, 18 November 2016, p. 61.

9 Ms Kris Peach, Australian Accounting Standards Board, *Committee Hansard*, 18 November 2016, p. 61.

> exactly what form of reporting you have to do. That is not the case [currently] in Australia.[10]

2.19 Given the views of AASB, the committee urges the government to set objective measures for the application of accounting standards under which the Australian subsidiaries of large multinationals would be required to file general purpose financial accounts and which would not allow these companies to avoid public scrutiny.

Committee view

2.20 The intense interest generated by this inquiry in the broader community demonstrates that Australians are concerned that the tax burden is not being shared fairly between personal and corporate taxpayers. Ongoing public scrutiny, including by this committee, is vital to holding foreign-based multinationals to account for their actions.

2.21 The committee reiterates its position that greater transparency in tax affairs is important both for addressing profit shifting by multinationals and maintaining public confidence in the integrity of the tax system. While the committee notes that a government consultation process is underway to develop a voluntary tax transparency code, it is deeply sceptical that a voluntary code will provide the necessary incentives for multinationals with questionable tax practices to disclose their affairs, and considers that a mandatory tax reporting code should be implemented as soon as practicable.

Addressing the root of the problem

2.22 Based on the information gleaned from the public hearings, it is clear that some multinationals will go to extreme lengths to conceal their tax minimisation practices, even under the intense scrutiny of a parliamentary committee. The secrecy about their tax arrangements together with the complicated nature of such arrangements pose a challenge for the ATO in unravelling and assessing the legitimacy of transactions. It is evident to the committee that recent legislative changes may not be sufficient to address the multinational profit shifting problem. There are two main areas—transfer pricing and interest deductions—where the present system architecture is not adequate and further reform may be warranted.

Transfer pricing

2.23 Australia's transfer pricing rules are modelled on the OECD guidelines for the trade of goods and services between related entities of a multinational corporation that operate in different jurisdictions. The OECD guidelines provide some discretion for companies to apply different approaches to determining appropriate transfer prices for

10 Ms Kris Peach, Australian Accounting Standards Board, *Committee Hansard*, 18 November 2016, p. 62.

their goods and services.[11] The transfer pricing regime favours multinationals with products and/or services that embody significant amounts of intellectual property and have highly integrated structures. Multinational companies with these characteristics include many of those involved in the digital technology and pharmaceutical industries. Indeed, given the importance of transfer pricing for the business model of 'big pharma', the ATO noted that 'the pharmaceutical industry has been at the forefront of transfer pricing for decades'.[12]

2.24 The transfer pricing rules effectively allow multinationals to charge Australian consumers whatever the market will accept and then shift the profits out of the country through transfer pricing. In these circumstances, the Australian subsidiaries are remunerated only for, and pay corporate tax on, the value added in the role as a distributor and/or facilitator of goods and/or services to Australian consumers. Evidence provided to the committee indicated that the profits, and thus tax paid, from these distribution activities represent only a fraction of total Australian revenue.[13]

2.25 In relation to the strategies used by 'big pharma' to minimise their tax obligations, there would appear to be a deliberate strategy of 'plausible deniability'. The committee was dumbfounded to learn that the executives of a number of multinational pharmaceutical companies knew almost nothing, if anything at all, about the transfer prices of identical products supplied to other international subsidiaries. For example, the Managing Director of Sanofi Australia indicated as much when questioned about whether he benchmarked the cost of goods in Australia to the cost of goods paid by subsidiaries in other jurisdictions.[14] Similarly, the General Manger of GlaxoSmithKline Australia and the Director of Market Access, External Affairs,

11 The two main approaches to transfer pricing are traditional transaction methods and transactional profit methods. Traditional transaction methods—the comparable uncontrolled price (CUP) method, the resale price method and the cost plus method—are regarded as the most direct means of establishing whether commercial and financial relations between associated entities are arm's length. Transactional profit methods—the transactional net margin method and the transactional profit split method—may be the most appropriate method in certain circumstances. Such circumstances include where entities have highly integrated activities, where there is no or limited publicly available gross margin information on third parties, or where each of the parties makes valuable and unique contributions in relation to a controlled transaction. OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrators*, July 2010, pp. 59–60.

12 Commissioner of Taxation, *Committee Hansard*, 1 July 2015, p. 48.

13 For example, the taxable income for Apple Australia represented between 2.5 and 4.5 per cent of revenue sourced from Australia between 2010 and 2015. Similarly, in the pharmaceutical industry, earnings before interest and tax (EBIT) ratios of between 4 and 8 per cent are considered appropriate by the ATO for a subsidiary only undertaking distribution activities. Apple Australia, *Answer to Question on Notice No. 17*, 28 April 2015, pp. 1-2; Commissioner of Taxation, *Committee Hansard*, 1 July 2015, p. 48.

14 *Committee Hansard*, 1 July 2015, p. 32.

Commercial Innovation and Legal at AstraZeneca Australia also provided responses indicating their ignorance of purchase prices in other jurisdictions.[15]

2.26 Pfizer Australia, likewise, insisted that it was in the dark when it came to the price that subsidiaries in other countries paid for identical products. When questioned whether the amount the Australian subsidiary paid for a particular product was the same as other subsidiaries, the Managing Director of Pfizer Australia, Mr Gallagher, insisted that it not within his scope of knowledge—he did not know the answer. Pressed on the importance of knowing what Pfizer was paying in Australia for a certain drug compared to other countries and the implications in terms of the rate of tax paid, Mr Gallagher replied:

> We follow the appropriate policies and procedures. I do not have that oversight into the other markets. All I have knowledge of is the market I operate in, which is here in Australia.[16]

2.27 Mr Gallagher repeated his statement:

> We follow the appropriate policies and procedures—the arm's length principles—and try to manage the business locally.[17]

2.28 Further, when asked to consider whether, as the CEO of the company, he did not ask, 'Perhaps if the Americans are paying a third what I am paying maybe I am getting ripped off here', Mr Gallagher again avoided the question, restating:

> We follow the procedures and policies and we manage the local business to the best of our ability.[18]

2.29 Apple came up with a similar explanation for not answering the question about comparable prices in other countries. Mr King said he was:

> …not familiar with the tax practices in America. I can talk about the tax practices here in Australia. That iPad would be bought at the arms-length price, which would be as if Apple in Australia were an independent entity buying that product from an offshore—[19]

2.30 The discussion then followed the same pattern as the pharmaceutical companies:

> Senator MILNE: Therein is the problem. You are acting as if you are a separate entity and you are not a separate entity; you are part of a global structure and you are fixing the prices around the world so you maximise your expenses here in this jurisdiction and then maximise your tax avoidance in a low-tax jurisdiction. Isn't that what Apple is doing?
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> Mr King: Senator, I reject that. We are following—

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15 *Committee Hansard*, 1 July 2015, p. 17.

16 *Committee Hansard*, 1 July 2015, p. 15.

17 *Committee Hansard*, 1 July 2015, p. 16.

18 *Committee Hansard*, 1 July 2015, p. 16.

19 *Committee Hansard*, 8 April 2015, pp. 48.

> Senator MILNE: Why? What is wrong with that statement?
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> Mr King: We are following globally accepted transfer pricing principles. We are following Australian transfer pricing principles in everything that we do here in the Australian market.
>
> Senator MILNE: I am not saying you are not following the law or you are not following principles. I am asking you as a matter of fact. You are sitting here saying that you are just familiar with the Australian tax arrangements of your Apple subsidiary here. What I am saying is that it is ridiculous to regard you as a single entity when you are part of a global company which is avoiding tax.
>
> Mr King: We do not avoid tax. We pay all of our taxes that are due in the Australian market in accordance with the law.
>
> Senator EDWARDS: You know where Senator Milne is going. It is getting painful again.[20]

2.31 In fact, in some cases as noted above, the Australian subsidiary is paying a much higher price for the same product.

2.32 The Commissioner of Taxation was similarly concerned about the evidence on transfer pricing and took note of the testimony provided by the pharmaceutical companies. He considered that there may be an inconsistency in the use of transfer pricing principles:

> One could perhaps see some inconsistency in the common theme that seemed to be stated this morning: that on the one hand they [multinational pharmaceutical companies] assert that they abide by the OECD guidelines on transfer pricing—arm's length pricing. On the other hand they seemed to have no idea what the pricing structure was in other areas. One could sort of look at that as somewhat of an inconsistency in statements. [21]

2.33 The Commissioner went on to say:

> The notion of arm's length does mean an independence of view. One would have thought that independence of view would include knowledge of a pricing structure, whereas in some cases I think it was simply said [by witnesses] that head office imposes a price and they take that price. In other examples, someone said, 'We ensure they never make a loss.' So there is a number of statements around not being independent and at arm's length; however, they say they act on an arm's length basis.[22]

2.34 Indeed, the Commissioner raised a fundamental question about the appropriateness of multinationals using (and abusing) transfer pricing principles:

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20 *Committee Hansard*, 8 April 2015, pp. 47–48.

21 Mr Chris Jordan, *Committee Hansard*, 1 July 2015, p. 48.

22 Mr Chris Jordan, *Committee Hansard*, 1 July 2015, p. 48.

> …is it really an arm's length distribution arrangement when they are clearly part of a worldwide function?[23]

2.35 While OECD transfer pricing principles may be the accepted practice, the evidence provided to the committee across a variety of industries confirms that the current transfer pricing regime does not serve Australia well from a tax revenue perspective. Effectively companies that do not have standardised pricing across jurisdictions can charge whatever the market will bear and then back out the profits through transfer pricing. Allowing multinationals, in effect, to arbitrarily attribute value between countries provides them with opportunities to price gouge Australian consumers while, at the same time, reducing the tax liabilities of their Australian subsidiaries.

2.36 Recent legislative changes and proposed Base Erosion and Profit Shifting (BEPS) recommendations will not radically change how transfer pricing principles are applied and, as such, it would be reasonable to conclude that foreign-based multinationals will continue to avoid paying tax that reflects the value of the business activities they conduct in Australia.

2.37 Transfer pricing could become even more important as companies restructure and create 'permanent establishments' in Australia in order to avoid being captured by the multinational anti-avoidance law (MAAL) which is effective from 1 January 2016. This development is particularly relevant to ensure that multinationals involved in the digital economy account for earnings in the jurisdiction where the activity occurs.

2.38 The nature of the digital economy provides opportunities for aggressive tax minimisation by allowing multinationals, such as Google, Microsoft, Uber and Airbnb, to deliver services using software platforms that can be located on the other side of the world. For example, Uber and Airbnb, based in Ireland and the Netherlands respectively, provide a platform for the exchange of services between Australians in Australia; yet the financial transactions associated with these services are undertaken in offshore jurisdictions and the Australian subsidiaries are reimbursed for expenses with a margin added on.

2.39 Emerging multinationals, such as Uber and Airbnb, are large enough to be captured by the significant global entity provisions and may choose to avoid the application of the MAAL (and the stronger penalties associated with it) by ceasing to book revenue overseas for the exchange of services between Australians in Australia. By booking revenues here, digital multinationals will move into a tax regime where the parent company will be reimbursed, through transfer pricing, for the intellectual property underlying the digital service. The creation of a permanent establishment should also give the ATO more access to information about the underlying corporate tax structure of these multinationals.

2.40 The committee does not accept the argument that activities within Australia represent only a small proportion of overall value creation, and considers that current transfer pricing principles need to be fully explored and, where necessary, redrafted to

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23 Mr Chris Jordan, *Committee Hansard*, 1 July 2015, p. 48.

ensure that transfer pricing cannot be manipulated to the detriment of Australian tax revenue. For example, if Australian consumers are paying higher prices for goods and services than a comparable product in other countries, then arguably this represents a value creation activity in Australia. Rather than just paying tax on a relatively small net profit margin for distribution services, corporate income tax liabilities could be calculated on the difference between the Australian price and the cost of supply to other countries.

Debt-related deductions

2.41 Another questionable practice employed by some companies that appeared before the committee was the use of internal loan arrangements to create debt-related deductions, thereby manufacturing opportunities to shift pre-tax profits out of Australia. For example, if multinational subsidiaries in low tax jurisdictions provide loans to subsidiaries in high tax jurisdictions, the interest payments can be tax deductible in the high tax jurisdiction while the interest payments received in the low tax jurisdiction are taxed at a lower rate.

2.42 In Australia, the most widely publicised case relating to multinational debt-related deductions involves a loan between Chevron subsidiaries. Chevron Australia has been engaged in a protracted disagreement with the ATO over interest related payments (primarily the rate of interest charged) on loans between the Australian subsidiary and affiliates based in the United States.

2.43 Debt-related deductions span a number of areas of the corporate tax regime, including thin capitalisation, hybrid mismatching and transfer pricing. One frustration for the committee was the very limited information that was publicly available which outlined 'real world' examples of aggressive tax minimisation using debt-related deductions in an Australian context. Hence, it was difficult for the committee to get an appreciation for the size and scope of this problem.

2.44 That said, the ATO considers the problem large enough to devote resources to pursuing companies in this area and even appears to be emboldened to take a harder stance on debt-related deductions based on recent positive court decisions in respect of Chevron and Orica. The Commissioner of Taxation announced:

> Cases featuring the same types of rolled up loans and intracompany financing arrangements will now be aggressively pursued.[24]

2.45 While there has been some work in this area, the committee believes that a more concerted effort is required to ensure that multinational companies do not employ such practices in order to deliberately avoid paying their fair share of tax in Australia. However, consistent with the transparency theme underlying the interim report, the committee reiterates its view that it would be in the public interest if the ATO were to report on the significance of debt-related deductions to the overall problem of aggressive tax minimisation and avoidance.

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24 Commissioner of Taxation, *Committee Hansard*, Additional Estimates, 10 February 2016, p. 66.

2.46 Further, the committee understands that the issue of debt-related deductions within Australia's tax system is currently being considered by the House of Representatives Standing Committee on Economics (HRSCE) inquiry into tax deductibility, but notes that the public commentary on this has primarily focused its application to personal income tax deductions. The committee urges the government to consider closely the impact and ongoing utility of corporate deductions, especially internal financing arrangements by multinationals.

Australian Taxation Office resourcing

2.47 This inquiry has provided a unique opportunity for the ATO and the Commissioner of Taxation to discuss multinational tax avoidance and aggressive minimisation in public forums. Indeed, the Commissioner has always made himself, and relevant staff, readily available to answer the committee's questions and appear at hearings.

2.48 The Commissioner himself has recognised the main impediments to addressing corporate tax avoidance and aggressive minimisation:

> I have said: 'Right now, I don't think it's the law; it's the cooperation of the companies; it's the ability to get things through the judicial system in a reasonable way; and it's a change in attitude on our behalf.'[25]

2.49 The committee is encouraged by the Commissioner's recent comments that the ATO is seeking to aggressively challenge egregious behaviour:

> These companies have pushed the envelope on reasonableness. They play games. They string us along. They believe we can be stooged. However, enough is enough and no more of this. We will be reasonable with those that genuinely cooperate, but we will now take a much harder stance on those who do not.[26]

2.50 This statement and the message it sends to all companies operating in Australia is welcome. However, it is also well overdue given that many of the main tax minimisation practices have been known for many years and, through this inquiry, have been shown to be at odds with community expectations. This was acknowledged by the Commissioner when explaining the change in ATO's approach:

> I wanted to make a very public statement, particularly in this forum [Senate Estimates], because, as the chair said, this forum, together with the corporate tax avoidance inquiry in the Senate, has exposed to the public a number of these issues. I wanted to use this forum to very publicly state the change in our [the ATO's] approach to reasonableness where we believe we have been unreasonably delayed or we are unreasonably not getting information so that we could build a case. We will now proceed to issue assessments on the best available information to us.[27]

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25 *Committee Hansard*, Additional Estimates, 10 February 2016, p. 69.

26 *Committee Hansard*, Additional Estimates, 10 February 2016, p. 66.

27 *Committee Hansard*, Additional Estimates, 10 February 2016, p. 70.

2.51 Having access to the relevant information is essential for the ATO to understand the business structures of multinationals operating in Australia and their tax obligations. However, it would appear that getting information from multinationals when that information is held offshore is not straightforward:

> Mr Jordan: ...Under our law—I think it is called a 'section 264A notice'; it is an offshore information request—we have to give 90 days' notice. So it is 90 days' notice, then the 90 days end. They say, 'Head office has been busy, people are away on leave—you know.' One company said that the phones were down in New York—it has just gone over the top.
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> Senator DASTYARI: And you have the power to seize documents—
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> Mr Jordan: Not if they are not in Australia. This is part of the problem; they do not put the documents here, I think for this reason—that we could go in and seize them if they were here. We have said 'Look—
>
> Senator DASTYARI: So at the moment, the tax office has incredible powers in terms of seizing documents, and part of the technique that is used is just never to keep those documents physically in Australia?
>
> Mr Jordan: With respect to some of these overall plans, I think that is right—yes. We cannot turn up in New York and enter and seize. We do not have jurisdiction—
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> Senator DASTYARI: And if you seize their Australian service, the documents do not exist?...Or you do not know whether they exist here or not, I suppose?
>
> Mr Jordan: That is one of the things—that we would not know whether they are there or not. Or we are told that they are not here, that they are held by the parent. So we ask for them and we do not get them…[28]

2.52 Mr Mark Konza, Deputy Commissioner International at the ATO, explained that as these companies are implementing global tax plans the information about them is generally held offshore. In addition to the tax plan, the ATO also needs to get access to any correspondence about the plan and related contracts.[29]

2.53 Indeed, the committee has noted the complicated structure of multinationals and the Australian representatives' apparent lack of knowledge of their company's international business. Representatives were particularly unaware of the facts around transfer pricing and the relationship between the location of certain entities in the company and the tax rate in the country in which they were located.

2.54 The ATO reported that it is overcoming the issue of access to offshore information by seeking to raise assessments based on the best available information.[30] However, a complementary approach that could streamline the information gathering

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28 *Committee Hansard*, Additional Estimates, 10 February 2016, p. 73.

29 *Committee Hansard*, Additional Estimates, 10 February 2016, p. 73.

30 Commissioner of Taxation, *Committee Hansard*, Additional Estimates, 10 February 2016, p. 73.

process would be to introduce stronger penalties for not providing the requested information about the tax structures of their multinational parents and related entities in Australia. Such an approach is consistent with the government's penchant for using stronger penalties to encourage multinationals to establish a taxable presence in Australia.

2.55 As stated in the committee's interim report of this inquiry, maintaining the integrity of the tax base is essential and maintaining public confidence in the tax administrator is an important element. Recent reforms and proposed actions arising from the BEPS project will create additional work for the ATO as multinationals seek to comply with the new rules and, in some cases, restructure their operations. In addition, significant resources are required to pursue complex cases of questionable tax practices, particularly where disputes are protracted and/or proceed to litigation. The Commissioner of Taxation reported the resources expended to date in the ongoing Chevron case:

> It cost us $10 million in out-of-pocket expenses for expert witnesses, legal counsel et cetera, let alone the time of people inside the ATO. There were something like 11 legal counsel for both sides, in excess of 12 expert international opinions and [for] what I would have thought was a relatively straightforward thing, a borrowing at 1.2 per cent, a currency swap from US dollars to Australian and a loan at nine per cent.[31]

2.56 The ATO has stated it is moving to a more proactive model of engagement but has not indicated whether increased funding has been provided to pursue this new approach. The committee reiterates its position that the ATO needs to be properly resourced and empowered to challenge the questionable tax practices of multinationals with deep pockets and everything to lose.

Conclusion

2.57 The committee notes the observation by the Commissioner of Taxation that the major obstacle to preventing multinationals exploiting Australia's taxation regime was not the law but the cooperation of the companies and the ability to get processes through the judicial system in 'a reasonable way'. He spoke of the way the companies 'push the envelope' and how they think they can 'stooge' the ATO. As amply demonstrated in the extracts provided in this chapter, the committee gained a similar impression of the multinational companies that gave evidence—their contrariness in answering questions, propensity to obfuscate, and, in some cases, simply not answering or deliberately misunderstanding the question.

2.58 While the committee recognises the determined stance the ATO is now taking, it is of the view that there is more scope for the government to assist the ATO in pursuing its mission to stop multinationals from gaming the system and 'stringing the ATO along'. The committee is particularly concerned about the resources available to the multinationals and their ingenuity in exploiting any loopholes in the laws. The

31 *Committee Hansard*, Additional Estimates, 10 February 2016, p. 74.

difficulty for the government and the ATO is to match this ingenuity and have the resources ready to challenge the companies.

2.59 In the following chapter, the committee considers recent developments and the opportunities available to make it difficult for multinationals to engage in aggressive tax minimisation practices.