Parliamentary
Budget Office

Policy costing

End corporate tax avoidance through artificial debt shifting into low-taxing jurisdictions	
Party:	Australian Greens
Summary of proposal: This proposal would change the thin capitalisation rules by removing the ‘safe harbour’ and ‘arm’s length’ debt tests, leaving only the ‘worldwide gearing’ debt test. The proposal would have effect for income years starting from 1 July 2019.	

Costing overview

This proposal would be expected to increase both the fiscal and underlying cash balances by $720 million over the 2019-20 Budget forward estimates period. This impact entirely reflects an increase in company tax revenue.

A breakdown of the financial implications of the proposal over the 2019-20 Budget forward estimates period has been included at Attachment A. The proposal would be expected to have an ongoing impact beyond the 2019-20 Budget forward estimates period.

The costing is subject to uncertainty around worldwide gearing ratios and potential behavioural responses of affected entities. There is currently limited information to determine the magnitude of worldwide gearing ratios of individual companies because only companies that use this test are required to report this information to the Australian Taxation Office (ATO), and very few companies have used this test. Changes in assumptions around the magnitude of worldwide gearing ratios could significantly alter the estimates. There are also uncertainties around growth in the level of debt, and the interaction between this proposal and the 2018-19 Budget measure *Tax Integrity – thin capitalisation – valuation of assets and treatment of consolidated entities* as both deny debt deductions. The 2019-20 Budget measure *Tax Integrity — extension and expansion of the ATO Tax Avoidance Taskforce on Large Corporates, Multinationals and High Wealth Individuals* could also have an interaction effect with this proposal as the compliance activities of the taskforce may affect some of the behavioural responses. However, the magnitude and timing of the interaction effect are too uncertain to be estimated in this costing.

Table 1: Financial implications ($m)[(a)(b)]

	2019–20	2020–21	2021–22	2022–23	**Total to 2022–23**
Fiscal balance	-	250	230	230	**720**
Underlying cash balance	-	250	230	230	**720**

(a) A positive number represents an increase in the relevant budget balance; a negative number represents a decrease.
(b) Figures may not sum to totals due to rounding.
- Indicates nil.

Key assumptions

The Parliamentary Budget Office (PBO) has made the following assumptions in costing this proposal.

- The available ATO company data on thin capitalisation shows that only a small number of companies have used the 'worldwide gearing' debt test to determine their allowable deduction amount, with most companies using the 'safe harbour' debt test. Consequently, most companies have not been required to submit information to the ATO on the level of their worldwide gearing.
  - In the absence of this information, the PBO has calculated the average worldwide gearing ratio for each industry group based on data from publicly available financial statements and de-identified data from the ATO for the 10 largest oil and gas companies in Australia. Companies are assumed to have a worldwide gearing ratio equal to the estimated average gearing ratio of their industry, which ranges from 0.39 to 0.85.
  - Companies that use the 'safe harbour' debt test are assumed to have a worldwide gearing ratio equal to or less than the safe harbour ratio of 0.6. An increase in revenue only arises where the worldwide gearing ratio is below the 'safe harbour' ratio.
- The costing makes an allowance for the possibility that some companies would alter their behaviour in order to avoid the impact of this proposal. This would reduce the revenue raised by 10 per cent after the first year of the proposal and by 2 per cent per year in subsequent years. This behavioural change could include changes to future worldwide financing arrangements to raise their worldwide gearing levels. In previous changes to the thin capitalisation rules, companies had altered their behaviour to avoid increases in debt deductions denied by revaluing their asset base. For this reason, and the uncertainty surrounding potential behavioural responses, the costing has factored in a further 50 per cent reduction in estimated revenue collections.
- The ATO would not vary the company pay-as-you-go (PAYG) instalments in the first year of this proposal (2019-20). Where this proposal results in higher income tax relating to the 2019-20 income year, this would be recognised and paid in subsequent years.

Methodology

The financial implications of this proposal were calculated based on ATO unit record data for thin capitalisation entities over the period from 2012-13 to 2016-17. The impact of this proposal was calculated by estimating the allowable debt deduction for each company under the proposal and subtracting the amount of current allowable debt deductions. An adjustment was made for the assumed behavioural response, weighted average company tax rate, and the estimated timing of tax payments.

There is a positive interaction effect between this proposal and the 2018-19 Budget measure *Tax Integrity – thin capitalisation – valuation of assets and treatment of consolidated entities.* This effect was measured by modelling the 2018-19 Budget measure under a worldwide-gearing-test-only scenario and comparing the estimates with those of the 2018-19 Budget.

Data sources

Australian Taxation Office, 2017. *Company tax return data for 2012-13 to 2016-17*, Canberra: Commonwealth of Australia.

Australian Taxation Office, 2017. *International Dealings Schedule Data*, Canberra: Commonwealth of Australia.

Australian Taxation Office, 2018. *Australian Taxation Office Submission to the Inquiry into Corporate Tax Avoidance and Minimisation*, Canberra: Commonwealth of Australia.

Commonwealth of Australia, 2019. *Budget 2019-20*, Canberra: Commonwealth of Australia.

Commonwealth of Australia, 2018. *Budget 2018-19*, Canberra: Commonwealth of Australia.

Commonwealth of Australia, 2013. *Budget 2013-14*, Canberra: Commonwealth of Australia.

Company level financial data were extracted from financial statements provided to the Australian Securities Exchange and the New York Stock Exchange.

The Treasury provided the modelling for the 2018-19 Budget measure *Tax Integrity – thin capitalisation – valuation of assets and treatment of consolidated entities*.

Attachment A – End corporate tax avoidance through artificial debt shifting into low-taxing jurisdictions – financial implications

Table A1: End corporate tax avoidance through artificial debt shifting into low-taxing jurisdictions – Fiscal and underlying cash balances ($m)(a)(b)

	2019–20	2020–21	2021–22	2022–23	**Total to 2022–23**
Company tax revenue	-	*250*	*230*	*230*	***720***
Total	**-**	**250**	**230**	**230**	**720**

(a) A positive number for the fiscal balance indicates an increase in revenue or a decrease in expenses or net capital investment in accrual terms.
A negative number for the fiscal balance indicates a decrease in revenue or an increase in expenses or net capital investment in accrual terms.
A positive number for the underlying cash balance indicates an increase in receipts or a decrease in payments or net capital investment in cash terms.
A negative number for the underlying cash balance indicates a decrease in receipts or an increase in payments or net capital investment in cash terms.

(b) Figures may not sum to totals due to rounding.

\- Indicates nil.