Centre for International Corporate Tax Accountability and Research

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Centre for International Corporate Tax Accountability & Research and Tax Justice Network - Australia Joint Submission on inquiry into *Treasury Laws Amendment (Making Multinationals Pay Their Fair Share – Integrity and Transparency) Bill 2023*

21 July 2023

The Tax Justice Network Australia (TJN-Aus) and the Centre for International Corporate Tax Accountability and Research (CICTAR) welcome this opportunity to make a joint submission to the inquiry into the *Treasury Laws Amendment (Making Multinationals Pay Their Fair Share – Integrity and Transparency) Bill 2023*.

Ensuring multinationals pay a fair share of corporate income tax is necessary for the broader integrity of the tax system and to level the playing field for all businesses, particularly small and medium sized enterprises. In addition to direct efforts to close loopholes for multinational tax avoidance and raise revenues for public services, we note that transparency efforts can increase corporate income tax revenue through shifting both corporate behaviour and public attitudes towards fair taxation. Since the COVID-19 global pandemic, there is a growing awareness of the essential need for well-funded public health systems and an understanding that additional revenues will be needed to pay for the increased government support provided to the community through the pandemic. There is also growing awareness that increased public investments are needed for aged care, early childhood education, disability services and income support and that these investments will create a better society and stronger economic future for all. Increasing income tax revenues from multinationals is an important part of the solution and also enhances fairness and broad-based economic growth.

TJN-Aus and CICTAR welcome this and other proposed multinational tax reforms from the Commonwealth Government, but continue to strive for broader reforms to national and international tax systems, including towards a unitary tax system and away from the arm's length principle.

Schedule 1 – Disclosure of Subsidiaries

With regards to the legislation's requirement for Australian public companies to disclose all subsidiaries and the jurisdiction or jurisdictions of tax residency, we strongly support this increase in transparency. We have previously supported this measure in Treasury's initial consultation on a package of multinational tax and transparency reform proposals. We note that our recommendation to disclose all subsidiaries, rather than those in jurisdictions that could be regarded as 'tax havens', has been incorporated.

The reform aligns Australia with current UK reporting requirements and away from the lack of transparency in current US reporting requirements. The US arrangements only require disclosure of 'material' subsidiaries, a highly subjective proposition. There is no obvious reason why a public corporation should not be required to disclose all subsidiaries. The requirement increases transparency for investors and all stakeholders.

We also provided a submission to Treasury's consultation on the draft legislation for the measure. We note that our suggestion to report on jurisdictions rather than countries of tax residence has also been incorporated. The requirement is important as the tax consequences between different jurisdictions in the same country can sometimes be significant.

We strongly support Schedule 1 as currently written and appreciate that it will enhance transparency for all Australian public companies without any significant increase in compliance costs.

Schedule 2 – Thin Capitalisation

As noted in the Exposure Draft Explanatory Memorandum, "excessive interest deductions (or debt deductions) pose a significant risk to Australia's domestic tax base."[1] The risk particularly applies where a corporation creates an arrangement to make interest repayments on a debt it owns to itself (through a subsidiary located in a low tax secrecy jurisdiction). When a corporation could finance an investment through equity, laws that allow it to make a loan to itself for the purpose of being able to claim interest repayments as a tax deduction operate effectively as a tax concession to the corporation. As the Explanatory Memorandum notes the OECD has observed "the use of third party and related party interest is perhaps one of the simplest of the profit-shifting techniques available in international tax planning. The fluidity and fungibility of money makes it a relatively simple exercise to adjust the mix of debt and equity in a controlled entity."[2]

The submitting bodies continue to be concerned that allowing interest repayments to related parties has been misused by corporations as giving them an acceptable limit of tax avoidance they are allowed to engage in through artificial debt loading through intra-party loans. In other words, the corporation makes a loan it does not need, as the financing in question could be provided through equity, from a low tax jurisdiction for the primary or sole purpose of avoiding paying tax in Australia through being able to claim interest repayments to itself as a tax deduction.

We strongly recommend that the group ratio rule should be regarded as the primary rule for entities that are members of a relevant worldwide group, and if a fixed cap is offered as an alternative, it should be set low. Multinational enterprises (MNEs) should only be allowed to claim their actual interest expense to third parties as a tax deduction, no more and no less.

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[1] *Treasury Laws Amendment (Making Multinationals Pay Their Fair Share – Integrity and Transparency) Bill 2023 Explanatory Memorandum,* 10.
[2] Ibid., 10.

There is plenty of evidence of great variations of gearing not only between different business sectors but even companies in the same sector. Evidence of the variation was provided in a study by PwC included in the comments by the Business at OECD (BIAC) on the BEPS Action 4 discussion draft.[3] Hence, the best and fairest method to accommodate interest payments as deductions is a Group Ratio Rule, as was recommended in Action 4 of the BEPS project in 2015.

We are disappointed the fixed ratio test will be set to allow claiming net debt deductions up to 30% of tax EBITDA, as we would have preferred to see a lower ratio. A PwC study showed that 55% to 61% of businesses had interest expenses less than 10% of EBITDA. Only 17% to 22% had a ratio over 30%.[4] Those with debt deductions of greater than 30% would include those with artificial debt arrangements designed to shift profits, so the proportion with genuine debt deductions of greater than 30% of EBITDA would be lower than that found in the PwC study.

Carry forward of interest payments that exceed the EBITDA ratio should not be permitted, unless they are assessed by the third party debt test to be attributable to genuine third party debt which is used wholly to fund Australian business operations. The inclusion of a carry forward provision of excessive debt deductions of 15 years does not curb profit shifting losses from government tax revenue, it spreads the losses into future years. Thus, the carry forward provision does not address the stated aim of the legislation to address the significant risk to Australian Government revenue from excessive interest and debt deductions. If carry forward of excessive debt deductions is to be allowed, then the case is strongest for smaller corporations that can have volatility in an investment that carries higher business risk, such as the development of a mine. Thus, any carry forward provision should not be allowed for a significant global entities as defined under Subdivision 960-U of ITAA 1997.

We welcome that the external third-party debt test will replace the existing arm's length debt test for 'general class investors' and financial entities.

We welcome that a general class investor and all of its associate entities must make a mutual choice to use the third party debt test, if any one of those entities wishes to use that test. We agree the safeguard is needed to ensure that general class investors and their associates are not able to structure their affairs in a way that allows them to artificially maximise their tax benefits by applying a combination of different thin capitalisation tests.

Impact Analysis for Schedule 1 – Public Country-by-Country Reporting

This current legislation does not include the implementation of promised public country by country reporting (CbCR) for all multinationals operating in Australia, which has now been delayed for a year. However, there is extensive discussion of this proposal, arguably the most significant multinational tax reform, in the Explanatory Memorandum (beginning on page 44 with "Attachment 1: Impact Analysis for Schedule 1"). Therefore, we offer comments on preserving the integrity of the measure. The importance and potential impact of robust public country by country reporting is readily apparent by the strong opposition to this measure from corporate lobbyists, which have not provided any verifiable, clear or compelling arguments to limit transparency.

While we are not opposed to further stakeholder consultation and ensuring compatibility with other international reporting requirements, the concerns of compliance burden and commercial sensitivities appear to be greatly exaggerated. We are deeply concerned that

[3] BIAC comments on Discussion Draft on BEPS Action 4 (February 2015), Part 1, 136.
[4] Ibid., 136.

further pressure from influential corporate lobbyists may result in reducing transparency and defeating the purpose of the reform. Public CbCR was an election commitment, a budget commitment and in draft legislation with the intension to be implemented on 1 July 2023.

While industry stakeholders have talked up compliance costs, no concrete estimates were offered in any submissions or consultations on this proposal. The Explanatory Memorandum estimates that the public CbCR requirement would apply to approximately 2,500 entities and compliance costs would be an estimated $10,000 per entity. It is further noted that “the compliance costs would be relatively minor compared to the revenues of in-scope multinationals.” In-scope multinational enterprises have been reporting similar data on a confidential basis to tax authorities under the OECD’s BEPS Action 13 for many years now. Multinational enterprises are already preparing to comply with the European Union’s (EU) public country-by-country reporting directive. Likewise, a growing number of multinational enterprises are reporting voluntarily under the relatively new Global Reporting Initiative’s (GRI) Tax Standard, upon which Australia’s public CbCR proposal is largely based.

It does not appear that any industry stakeholders have provided any concrete examples of potential harm from disclosure of the required either. Disclosure by multinational entrerprises of basic financial information on a country-by-country basis does not reveal commercially sensitive information. Large financial sector firms (banks) in the EU have been required to disclose public country-by-country information for nearly a decade, since 2014, with no apparent negative impact on competition due to increased transparency.

In addition, the government has caved in to industry lobbying and agreed to remove four data fields from the initial proposal in the draft legislation. No further changes should be made to appease unverifiable industry concerns. The alignment of these fields with other global reporting requirements is justifiable. However, the notion that Australia’s public CbCR should align with the narrow geographic scope of the EU CbCR directive is deeply flawed and should be avoided.

The current EU CbCR directive was already weakened by intense corporate lobbying. The EU directive requires reporting only on EU member states and a flawed and incomplete blacklist of non-cooperative jurisdictions (‘tax havens’). The rest of the world is treated as one lump sum. The global aggregation in the EU CbCR is, by definition, not country by country reporting. While the EU CbCR is an improvement in transparency, it may not expose multinational corporate profit shifting, which should be a primary objective of CbCR. In fact, the EU approach may create perverse incentives to move tax avoidance schemes from Ireland and Luxembourg to Singapore and Switzerland, or dozens of other jurisdictions outside the scope of EU reporting.

While the geographic scope of the EU CbCR directive is deeply flawed in the European context, it is absurd to apply this concept to Australia. In Australia, we already have over five years of reporting on tax payments of large Australian companies through the ATO’s corporate tax transparency data. The primary purpose of public CbCR reporting is to expose where profits are shifted, reporting on data in only Australia would fail to meet this primary purpose.

If a multinational enterprise is not engaged in profit shifting, it should have nothing to fear in an increase in transparency. The vehement corporate lobbying against Australia’s proposed public CbCR legislation, suggests that many multinational enterprises would strongly prefer to keep the public in the dark about the reality and scale of global profit shifting practices.

Increased corporate tax transparency is integral to restoring and maintaining broader community trust in the tax system. It is deeply unfair when underpaid nurses, or other essential workers, pay a higher rate of tax on their personal income than some of the world’s

largest and most profitable multinational corporations. Such a two-tiered system, with different sets of rules for those with financial resources, must end so that we can fully fund essential public services and reduce inequality, nationally and globally.

Australia must not bend to pressure from multinational corporate tax dodgers – and enablers, including PwC and the other Big 4 accounting firms – and should implement full public CbCR as proposed and promised. There is an undeniable trend towards greater tax transparency. If Australia takes the lead, other jurisdictions will follow and set a new global standard. Australia should not be held back by current flaws and failures in current OECD or EU approaches to country-by-country reporting.

Thank you for the opportunity to provide the above submission. We hope that the Committee understands that civil society networks and organisations, such as ours, are grossly under-resourced in the capacity to represent the broad public interest and counter well-resourced corporate lobbying to preserve the unfair status quo and maintain secrecy. Please let us know if you have questions or require further information.

Sincerely,

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Background on the Centre for International Corporate Tax Accountability & Research (CICTAR)

CICTAR is a global corporate tax research centre that produces information and analysis to untangle the corporate tax web. The Centre is a collective resource for workers and the wider public to understand how multinational tax policy and practice affects their daily lives. CICTAR's work supports public participation in the tax debate so that everybody can take part in decision-making that affects their communities.

For more information, visit the CICTAR website here: https://cictar.org/

Background on the Tax Justice Network Australia

The Tax Justice Network Australia (TJN-Aus) is the Australian branch of the Tax Justice Network (TJN) and the Global Alliance for Tax Justice. TJN is an independent organisation launched in the British Houses of Parliament in March 2003. It is dedicated to high-level research, analysis and advocacy in the field of tax and regulation. TJN works to map, analyse and explain the role of taxation and the harmful impacts of tax evasion, tax avoidance, tax competition and tax havens. TJN's objective is to encourage reform at the global and national levels.

The Tax Justice Network aims to:

(a) promote sustainable finance for development;
(b) promote international co-operation on tax regulation and tax-related crimes;
(c) oppose tax havens;
(d) promote progressive and equitable taxation;
(e) promote corporate responsibility and accountability; and
(f) promote tax compliance and a culture of responsibility.

In Australia, the current members of TJN-Aus are:

- ActionAid Australia
- Aid/Watch
- Anglican Overseas Aid
- Australian Council for International Development (ACFID)
- Australian Council of Social Service (ACOSS)
- Australian Council of Trade Unions (ACTU)
- Australian Education Union (AEU)
- Australian Manufacturing Workers Union (AMWU)
- Australian Nursing & Midwifery Federation (ANMF)
- Australian Services Union (ASU)
- Australian Workers Union, Victorian Branch (AWU)
- Baptist World Aid
- Caritas Australia
- Centre for International Corporate Tax Accountability & Research (CICTAR)
- Community and Public Service Union (CPSU)
- Electrical Trades Union, Victorian Branch (ETU)
- Evatt Foundation
- Friends of the Earth (FoE)
- GetUp!
- Greenpeace Australia Pacific
- International Transport Workers Federation (ITF)
- Jubilee Australia
- Maritime Union of Australia (MUA)
- National Tertiary Education Union (NTEU)
- New South Wales Nurses and Midwives' Association (NSWMWA)
- Oaktree Foundation
- Oxfam Australia
- Save the Children Australia
- Save Our Schools
- SEARCH Foundation
- SJ around the Bay
- Social Policy Connections
- TEAR Australia
- The Australia Institute
- Union Aid Abroad – APHEDA
- United Workers' Union (UWU)
- Uniting Church in Australia, Synod of Victoria and Tasmania
- UnitingWorld
- Victorian Trades Hall Council
- World Vision Australia