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Submission on Tax Laws Amendment (Combating Multinational Tax Avoidance) Bill 2015

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According to the OECD corporate tax avoidance costs national governments some US$100 – 240 billion per annum.[1] Australian industry is largely foreign-owned with 41 per cent of all shares of Australian corporations held overseas and 61 per cent of all listed shares held by overseas owners.[2] With such high levels of foreign ownership we expect that Australia is likely to suffer disproportionately from high corporate tax avoidance.

We begin by noting the need for very strong tax avoidance measures to counter big business strategies. We like to think that things like tax avoidance and evasion are confined to a minority. Work that we referred to in an earlier submission[3] makes it clear that tax avoidance is endemic and that big business virtually sees it as their obligation to avoid tax wherever possible. The Australian Financial Review reported that 'Grant Thornton's global leader for tax services Francesca Lagerberg said as long as businesses operated within regulatory boundaries, they still had a responsibility to their investors to keep costs down, "and this includes tax"'.[4]

That attitude, that there is an almost moral obligation to avoid tax, stands in dramatic contrast to the ordinary taxpayer and we note that the present administrative arrangements are based on the premise that most taxpayers are honest and make honest declarations in their tax returns. That applies especially to the self-assessment model which was introduced in 1992 under the Keating Government and subsequently reviewed and finessed by the Howard Government.

In contrast to the attitude of big business, the corporate sector earns some 27 per cent of all income in Australia[5] and so should pay a substantial proportion of the total tax collection. The 2015-16 budget estimates that the corporate tax take will be 25 per cent of all income tax.[6] Given that a lot of Australia's income is earned by people who pay much less than the company tax rate of 30 per cent we think companies should be paying correspondingly more than their income share. When franking credits are deducted from the corporate tax collection the proportion paid by companies in Australia falls to 13 per cent of total income tax collections.[7]

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[1] OECD (2015) OECD/G20 Base Erosion and Profit Shifting Project: Explanatory Statement, 2015 Final Reports, http://www.oecd.org/tax/beps-2015-final-reports.htm

[2] ABS (2015) *Australian National Accounts: Finance and Wealth, Jun 2015*, Cat no 5232.0, 24 September.

[3] Richardson D (2015) *Corporate Tax Avoidance: Submission*, February.

[4] Khadem M (2015) 'BEPS plan puts companies in the firing line, say experts', *The Australian Financial Review,* 7 October. http://www.afr.com/news/policy/tax/beps-plan-puts-companies-in-the-firing-line-say-experts-20151006-gk26tm#ixzz3nr4YQL60

[5] ABS (2014) *Australian System of National Accounts, 2013-14*, Cat no 5204.0, 31 October.

[6] Australian Government (2015) 'Statement 4 – Revenue', *2015-16 Budget Paper no 1*.

[7] The ratio of franking credits to corporate tax payments was calculated using figures from ATO (2015) *Australian Taxation Statistics, 2012-13*.

Details of the bill:

The present bill is presented in four schedules which refer respectively to

1. Who is to be covered: **Schedule 1—Significant global entities**
2. The subject matter covered in the bill: **Schedule 2—Multinational anti-avoidance**
3. New penalties for multinationals engaging in avoidance: **Schedule 3—Scheme penalties for significant global entities**
4. And the provision of additional information to assist the Tax Office: **Schedule 4—Country-by-Country reporting**

FIRST SCHEDULE

On the face of it there seem to be few problems with the first schedule in defining what a significant global entity may be which then defines the scope of the legislation. The main definition refers to the parent entity of the entity operating in Australia and uses a definition of an entity with a global turnover of $1 billion or more. The definition also includes a group of related entities which should overcome the problem of shelf off-shore companies controlling the Australian entity. The Tax Office might be quizzed on whether or not there may be limitations in the approach here.

SECOND SCHEDULE

The second schedule does a number of things. In his second reading speech the then Treasurer said ‘By removing the 'no-tax or low-tax' condition and relying solely on a 'principal purpose' test, we are sending a clear message that, if you deliberately and artificially avoid paying tax in Australia, this is not acceptable’.

This schedule includes the definition of schemes that are the subject of the legislation. Paragraph 177DA(1)(a) says:

(a) under, or in connection with, the scheme:

(i) a foreign entity makes a supply to an Australian customer of the foreign entity; and

(ii) activities are undertaken in Australia directly in connection with the supply; and

(iii) some or all of those activities are undertaken by an Australian entity who, or are undertaken at or through an Australian permanent establishment of an entity who, is an associate of or is commercially dependent on the foreign entity; and

(iv) the foreign entity derives ordinary income, or statutory income, from the supply; and

(v) some or all of that income is not attributable to an Australian permanent establishment of the foreign entity; …

The heart of it seems to be the following words in the definition of tax avoidance: 'the foreign entity derives ordinary income' but 'income is not attributable to an Australian permanent establishment'. We could interpret this as asking whether the multinational's account of where it earns its money fails the pub test. This part seems adequate on the face of it although it is worth asking the ATO whether or not they think it adequate. For instance, Chevron is reported to have borrowed money at very cheap international rates and on-lent to its wholly owned Australian subsidiary with a massive premium. It claims that the difference reflected the additional risk associated with the subsidiary. We understand this is still in dispute but the question is whether or not this sort of obvious avoidance would be readily countered by the new measures in schedule 2. That needs to be addressed to those with much more expertise.

We also note that Action 4 of the OECD's BEPS project provides for action against unwarranted interest deductions between related entities. When the work on that is finished how is it expected things will unfold at that point?

Major tax avoidance schemes involve high tech multinationals which tend to involve related corporations buying and selling intellectual property rights, management services and the like across national borders. Are those sorts of avoidance addressed? A solution was proposed to the Senate in the earlier submission referred to above.

Having made the prima face case under par (a) then the next paragraph is critical and it is that to which we now turn.

In the arrangements relating to tax avoidance schemes the bill imposes a new paragraph 177DA(1)(b) which reads:

(b) it would be concluded (having regard to the matters in subsection (2)) that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme did so for a principal purpose of, or for more than one principal purpose that includes a purpose of:

> (i) enabling a taxpayer (a ***relevant taxpayer***) to obtain a tax benefit, or both to obtain a tax benefit and to reduce one or more of the relevant taxpayer's liabilities to tax under a foreign law, in connection with the scheme; or
>
> (ii) enabling the relevant taxpayer and another taxpayer (or other taxpayers) each to obtain a tax benefit, or both to obtain a tax benefit and to reduce one or more of their liabilities to tax under a foreign law, in connection with 28 the scheme;
>
> whether or not that person who entered into or carried out the scheme or any part of the scheme is the relevant taxpayer or is the other taxpayer or one of the other taxpayers;…

Ignoring the complications here the critical words are that the person/s carried out the scheme 'for a principal purpose of, or for more than one principal purpose that includes a purpose of' avoiding tax.

We are concerned that this means that in the event of a dispute the Tax Office would have to prove that there was a purposeful behaviour on the part of a person in the entity. We admit that the language is similar to that used elsewhere in Part IVA (the general tax avoidance measures) but nevertheless the Tax Office needs to be queried as to whether the present language could be an issue and whether the existence of activity likely to have had its purpose in avoidance should be sufficient for the Tax Office to act. Given the obligation to avoid tax on the part of business we need to ask whether stronger language and tools are not needed.

SCHEDULE 3

Schedule 3 doubles the penalties applying to multinationals in relation to tax avoidance – this seems to be fine with the following qualifications. In practice many penalties seem to be waived. The total value of all penalties collected by the Tax Office in 2013-14 was $788 million which includes all penalties generated by all tax areas. The general penalty for tax avoidance is 50 per cent but penalties are waived or significantly reduced where the law is in doubt. In addition many matters are settled through negotiation between the taxpayer and Tax Office. Hence the doubling of penalties may not mean much in practice. We would hope that the especially egregious examples should receive very strict penalties and have in mind some of the schemes reported in the media including Apple, Google, Chevron, BHP Billiton etc.

SCHEDULE 4

Schedule 4 provides for the country-by-country reporting called for by the OECD BEPS agreement. The bill says this gives rise to the OECD agreement. The proposed Subdivision 815-E says:

> This Subdivision enables the implementation of measures issued by the Organisation for Economic Cooperation and Development relating to transfer pricing documentation and country-by-country reporting.

On the face of it this seems fine but the ATO needs to be asked as to whether or not it gives them everything they need. We note that when other countries make and share similar arrangements there will scope for cross-checking.

The legislation makes it clear that the standard of information it seeks is consistent with the 'Guidance on Transfer Pricing Documentation and Country-by-country Reporting of the Organisation for Economic Cooperation and Development and the G20'. On the face of it this seems to implement the BEPS Action 13 but clarification should be sought.

Of course this measure does not address the aim of naming and shaming tax avoiders unless the information is made public. The public has a right to know this sort of information. More importantly, public pressure to be a 'good corporate citizen' is needed to overcome the natural inclination of the corporate sector to do almost anything to avoid paying tax. Companies like Apple and Google and others engaged in retail markets care a good deal about their corporate image.

General

People such as the representatives of the Business Council of Australia have urged the government not to implement anything beyond the OECD measures. All we need do is point out that their hands are not clean: many and probably most of the BCA members have foreign owners and/or foreign subsidiaries and are most likely engaged in at least some tax avoidance via international transactions. The work of the Tax Justice project showed that the top 100 corporations in Australia regularly engage in avoidance schemes involving profit shifting abroad and keep subsidiaries in tax havens for just that purpose. [8]

The OECD makes the important point that tax avoidance is aggravated by 'limited country enforcement resources'. We are aware that Australian Government entities often forgo action against multinationals because there are concerns that their limited budgets will not be sufficient to win a court case.[9]

According the 2015-16 Budget Paper No 2 the present measures will require expenditure of $11.3 million over the forward estimates. Will that be enough to cover court and other costs to counter litigious multinationals? What would happen if the Tax Office legal costs looked like blowing out well beyond the additional expenditure?

[8] United Voice and Tax Justice Network (2014) *Who pays for our common wealth? Tax practices of the ASX 200*,

[9] For example in the therapeutic goods area the relevant agency cannot afford action that it should take. See Tucker K (2013) Culture of resistance: Australia's response to the inappropriate use of antimicrobials, *The Australia Institute Policy Brief*, No 46, February.