24 April 2013

General Manager
Revenue Group Law Design Practice
The Treasury
Langton Crescent
PARKES ACT 2600

Attention: Philip Ackroyd

Via email: **TaxTransparency@treasury.gov.au**

Dear Sir,

Improving the Transparency of Australia's Business Tax System

The Australian Financial Markets Association (AFMA) represents the interests of over 130 participants in Australia's wholesale banking and financial markets. Our members include banks, securities companies, treasury corporations, traders across a wide range of markets and industry service providers. AFMA welcomes the opportunity to make a submission on the Discussion Paper entitled "Improving the transparency of Australia's business tax system" (**the Discussion Paper**). Our submission focusses on the issues detailed under the heading "Transparency of Tax Payable by Large and Multinational Business."

AFMA's submission is structured in the following way. Firstly, based on the existing policy and legislative frameworks regarding the confidentiality of taxpayer information, we set out what AFMA contends are the threshholds that the Government needs to meet to warrant the public disclosure of otherwise confidential information. We express the view, based on these threshholds, that the Government has not properly articulated why, on balance, the disclosure is in the public interest. Accordingly, AFMA cannot support the public disclosure of taxpayer information at present.

Secondly, in the event that the Government proceeds with the proposal to make certain taxpayer information public regardless, we have set out specific concerns and recommendations in relation to the proposed measures.

We note that the gravity of the proposed changes are such that there needs to be significant consultation with affected entities to ensure that any proposed disclosures to the public are justifiable and appropriate. AFMA submits that there would need to be further consultation in respect of any proposed law that Governments seeks to introduce, if that is the path that the Government determines to make.

Part 1: Making the Case for Reform

Fundamental right to confidentiality

The confidentiality of taxpayer information provided to a taxation officer is a fundamental tenet of the taxation administration systems of both Australia and global equivalents. For example, the OECD, in its publication "Keeping It Safe: The OECD Guide on the Protection of Confidentiality of Information Exchanged for Tax Purposes," acknowledged the importance of keeping taxpayer information private by stating:

> "Confidentiality of taxpayer information has always been a fundamental cornerstone of tax systems. In order to have confidence in their tax system and comply with their obligations under the law, taxpayers need to have confidence that the often sensitive financial information is not disclosed inappropriately."

This position is consistent with the policy position that has been adopted in Australia and reflected in relevant Australian legislation. Even as recently as 2010, the Minister for Financial Services, the Honourable Bill Shorten MP, in announcing the passage of a bill in Parliament streamlining and improving tax secrecy and disclosure provisions (now enshrined in Division 355 of the *Taxation Administration Act 1953* (**TAA**)), noted that taxpayers provide personal information to the Australian Taxation Office (**ATO**) on the basis that it remain confidential and said:

> "Taxpayers have an expectation to the right to privacy of all confidential information provided to the ATO."

This position, which AFMA supports, was reflected in the Explanatory Memorandum to the Bill that introduced Section 355-25 into the TAA, which stated:

> "The primary objective of the new framework is to protect the confidentiality of taxpayer information. Compliance with taxation laws could be adversely affected if taxpayers thought that their information could be readily disclosed."

Disclosure warranted in the public interest

The objects clause to Division 355 of the TAA states that "The disclosure of information about the tax affairs of a particular entity is prohibited, except in specified circumstances. These exceptions are designed having regard to the principle that disclosure of information should be permitted *only if the public benefit derived from the disclosure outweighs the entity's privacy* (emphasis added)."

The exceptions that exist in Division 355 of keeping taxpayer information confidential include the following:

- Disclosure to law enforcement agencies or courts/tribunals in respect of the investigation and prosecution for a serious offence;
- Disclosure to Australian government agencies to prevent or lessen a serious threat to the health and safety of either an individual or the public;
- Disclosure to the Treasury to allow the Treasurer to make decisions under the *Foreign Acquisitions and Takeovers Act*;
- Disclosure to the Australian Securities and Investments Commission (**ASIC**) for the purpose of enforcing a law administered by ASIC; and
- Disclosure to the Fair Work Ombudsman to allow for the better targeting of compliance activity.

The common element to each of these exceptions is existence of the strong public interest to rebut the presumption of confidentiality and tipping the balance towards disclosure. These exceptions show that in order to justify the disclosure of otherwise confidential information, it is incumbent on the Government to demonstrate that the public interest in such disclosure is sufficiently strong, that is, to use the words in Division 355 of the TAA, outweighs the entity's privacy.

Demonstrating breaching confidentiality is warranted

It is AFMA's view that the Government has failed to discharge its requirement in the Discussion Paper (or elsewhere) as to why the presumption of confidentiality is to be displaced in relation to the disclosure of otherwise confidential information for corporate taxpayers with total income in excess of $100 million. In order to demonstrate that the disclosure is warranted, it would, in AFMA's view, be necessary to:

(i) Set out the public interest objectives that would be served by the disclosure and articulate why these objectives are, on balance, more important than the maintenance of confidentiality; and
(ii) Specifically demonstrate why the disclosure would further these objectives such that the making of the disclosure is in the public interest.

The Discussion Paper states that the objectives of publication is to "enable the public to better understand the corporate tax system and engage in tax policy debates, as well as to discourage aggressive tax minimisation practices by large corporate entities." The Assistant Treasurer's Press Release from 4 February 2013 states that "(i)mproving the transparency of Australia's business tax system will encourage enterprises to pay their fair share of tax and discourage aggressive minimisation practices." AFMA agrees that the objectives of educating the public to better understand the corporate tax system and to discourage aggressive tax minimisation practices by large corporate entities are in the public interest.

However, the Government needs to express why the objectives are sufficiently in the public interest to, in the words of Division 355 of the TAA, outweigh the entity's privacy. As noted above, to disclose otherwise confidential taxpayer information is a significant step given the existing policy and legislative frameworks and yet there is not any analysis as to why such a significant step is justified.

Further, even if the proposition that the policy objectives objectives are sufficiently in the public interest so as to warrant the disclosure of confidential information, neither the Discussion Paper nor the Assistant Treasurer's Press Release of 4 February 2013 provide any basis as to why the disclosure of the tax information in any way promotes these objectives.

In particular:

- In terms of the goal of educating the public on the corporate tax system and arming them with sufficient knowledge to engage in policy debates, in AFMA's view there is no reason as to why this goal cannot be pursued while preserving the confidentiality of taxpayer information. That is, the public can be educated on the basis of macro and publicly available information, especially noting the wealth of information that large corporate taxpayers provide to the ATO. Moreover, for the reasons set out below, the proposed particular disclosures of total income, taxable income and income tax payable (and these disclosures alone) may actually undermine the public's understanding of the tax system through being misleading, as opposed to informative; and
- There is no further articulation in the discussion paper as to why compelling the disclosure of certain information would discourage aggressive tax minimisation practices by large corporate entities. In some circumstances, the disclosure framework may incentivise taxpayers to adopt structures that ensure that they do not have total income exceeding $100 million in a particular income year, so as to be removed from the disclosure requirement.

Conclusion

In short, it is AFMA's view that it is necessary for the Government to make the case as to why the proposed disclosure of otherwise confidential taxpayer information is sufficiently in the public interest to justify the breach of privacy. Through neither explaining why the policy objectives are sufficiently in the public interest, nor explaining why the disclosures would promote such objectives, the Government has not provided sufficient justification as to why the reforms are warranted. Accordingly at this time, AFMA does not support the disclosure of taxpayer information to the public as countenanced by the Discussion Paper.

Part II: Specific Concerns and Recommendations

ATO well-resourced to promote policy objectives

AFMA notes that the information currently provided by "large corporate entities" to the ATO under current disclosure requirements is more than ever before. In addition to the disclosures in the Company Tax Return, large corporate entities are required to lodge some or all of the following:

- Capital Gains Tax Schedule;
- International Dealings Schedule;

- Losses Schedule;
- Capital Allowances Schedule;
- Research and Development Tax Incentive Schedule; and
- Reportable Tax Positions Schedule.

The information provided by large corporate taxpayers allows the ATO to apply its Risk Differentiation Framework to determine the risks that exist within the large corporate entities. In particular, the new Reportable Tax Positions schedule requires taxpayers to disclose those positions that they may view as contentious or ambiguous in terms of interpretation. This will allow the ATO to properly focus their attention to the areas that the taxpayer believes may be a higher risk.

Through its Pre-Compliance Review process, the ATO is able to engage with taxpayers prior to the lodgement of the return so as to properly understand the taxpayers' business, commercial drivers, structures, governance processes and taxation risks, thereby allowing the ATO to undertake a real time assessment of the taxation risks.

Given the extent of the information held by the ATO in respect of large corporate tax entities, AFMA believes that the ATO is best placed to promote the policy objectives that the Discussion Paper asserts warrant the public disclosure of taxpayer information. In relation to discouraging "aggressive tax minimisation practices," the wealth of information held by the ATO should allow the ATO to conduct appropriate compliance activities and prosecute those that have not adhered to their obligations with all of the powers available to the ATO as the administrator of Australia's tax system. Further, the ATO is armed with all of the information that would be required to educate the public on the practices and issues associated with taxpayers in different industries/demographics, and could do so without breaching existing confidentiality provisions.

Proposed disclosures not address "stateless income"

AFMA understands that one of the principal reasons for Treasury proposing the disclosure of taxpayer information is a concern regarding "stateless income," which broadly has been defined as:

> "income derived by a multinational group from business activities in a country other than the domicile, however defined, of the group's ultimate parent company, but which is subject to tax only in a jurisdiction that is not the location of the firm's customers or the factors of production through which the income was derived…[1]"

Based on the proposals set out in the Discussion Paper, in order for a corporate tax entity to have its information disclosed to the public, it would be necessary for the taxpayer to have disclosed total income on the company tax return in excess of $100 million. This disclosure would be in respect of income derived in Australia, i.e. not

[1] Edward D. Kleinbard, Stateless Income, 11 Fla. Tax Review (699)

attributable to an overseas operation or permanent establishment, and hence will generally comprise income that is sourced in Australia for tax purposes.

To the extent that a corporate tax entity does not derive Australian sourced income, through the use of structures that give rise to “stateless income,” such income may not be included in the “total income” disclosed at Item 6 of the Company Tax Return. Accordingly, as the corporate tax entity will not exhibit total income in excess of $100 million, its information will not be disclosed.

Hence, the framework for disclosure as set out in the Discussion Paper would not allow for the disclosure of information regarding structures about which concern has been expressed. Of greater concern is that the disclosure framework could incentivise taxpayers to adopt structures that reduce total income to below $100 million so as to escape the disclosure requirement.

Disclosure of reported total income

It is proposed that corporate tax entities with a “total income” of more than $100 million will have the following information disclosed:

- Reported total income;
- Taxable income; and
- Income tax payable.

The discussion paper notes that the concept of an entity’s “total income” is not defined in the tax laws and it is envisaged that the Commissioner will rely on the disclosure at question 6 of the Company Tax Return. The Discussion Paper concedes that the term “total income” is not one that is defined in the tax law. AFMA has two principal concerns with this approach.

Firstly, disclosing a number that has not been defined in the tax law and is not a concept understood by anyone apart from taxation compliance professionals, is at odds with the stated objective of the proposed disclosures of helping the public better understand the corporate tax system. Enhancing the understanding of the system should build on whatever base of knowledge is held by the public at present, not introduce novel concepts.

Secondly, the concept of total income as disclosed at Item 6 of the Company Tax Return bears no resemblance to the economic performance of the entity, as it is a gross concept and does not take into account expenditure. Accordingly, corporate tax entities that suffer an economic loss in a particular income year, but with total income in excess of $100 million, will still have their information disclosed to the public, in a form that does not reveal that the entities were in losses.

The propensity of this disclosure to mislead is exacerbated when it is considered across different industry segments. For example, an entity carrying on a banking operation will generally have interest expense that is approximately equal to interest income. Commercially, the appropriate metric of the income of the bank is the net difference between the interest income and the interest expense; however the disclosure of "total income" will only provide the income number. Clearly this has the ability to confuse without proper explanation.

One-year snapshots misleading

There are many reasons why, even for a simple corporate entity, there will be considerable disconnect between the concepts of total income, taxable income and income tax payable. Notwithstanding the clear lack of nexus between total income and taxable income as noted above, there are also explicable reasons as to why the income tax payable does not correlate precisely to taxable income, such as the claiming of foreign income tax offsets and research & development offsets. Further, in a particular income year, a corporate tax entity may recoup prior year losses, which will reduce taxable income and income tax payable.

Merely disclosing total income, taxable income and income tax payable for a particular income year would exacerbate the misleading nature of the disclosures and, in AFMA's view. To the extent that disclosures are required, AFMA would advocate the disclosure of rolling three or five year disclosures that would portray a more meaningful view of the entity's tax profile.

Application to tax consolidated groups

The Discussion Paper does not elaborate on how the proposed disclosures are to be made with reference to entities that are within a Tax Consolidated Group. In particular, the Discussion Paper states that "the Commissioner would publish [the] Australian Business Number (ABN) and name."

Under the Tax Consolidation regime, the head company of the tax consolidated group lodges the tax return for the group. In this instance, it will be the ABN of the head company of the group that is disclosed to the ATO.

It may be case that the head company of the consolidated group does not have "total income" in excess of $100 million and it may further be the case that none of the entities within the group exceed the disclosure threshold. However, given the aggregation of the income of the group as required under the consolidation regime, disclosure may be required based on the group's total income. This would appear to create an incentive not to enter into the consolidation regime and rather lodge a return on a standalone basis so as to prevent disclosure.

Consolidated groups, and particularly Multiple Entry Consolidated Groups, may operate on a diversified basis and could potentially include a number of discrete businesses (which may or may not have total income in excess of $100 million on a standalone basis). Hence, disclosing the name and the ABN of the head company of the consolidated group is unlikely to provide the public with any meaningful information regarding the tax profile of the underlying business(es) and may lead to further confusion.

If it is the intention that the disclosures are to be made on a standalone basis, notwithstanding the consolidation provisions, then the ATO would need to disclose the relative contributions made by the subsidiary members of the consolidated group to the overall tax liability of the group. This would require an understanding of the consolidated group's tax sharing and tax funding arrangements, which are not currently provided to the ATO.

Application to trusts

It is noted that the proposed disclosure requirements only apply to "corporate tax entities," defined to include companies, corporate limited partnerships, corporate unit trusts and public trading trusts. That is, "flow-through" trusts that are generally not taxed in their own right would appear not to have a disclosure obligation.

There does not appear to be a sound policy basis for the exclusion of trusts, given the popularity of such vehicles in investment structures in Australia. The lack of application to trusts would appear to provide a further incentive to use such vehicles. This may affect Australian tax revenues given that trust income is generally taxed only in the hands of presently entitled beneficiaries and, which may or may not be outside Australia. Such income would be taxed in Australia on an assessment basis for a corporate taxpayer.

Exemption for publicly listed entities

Publicly listed entities (or groups of entities), such as those listed on the Australian Securities Exchange, are compelled to disclose significant taxation related information to the public to adhere to periodic disclosure requirements. In particular, such entities are required to reconcile the accounting profit to the taxable income that results in the total average effective tax rate for the entity/group. This may require the disclosure of the tax rate effects of the following:

- Exempt income;
- Non-deductible expenses;
- Impairment of goodwill;
- Tax losses;
- Overseas tax rate differentials; and
- Changes in tax rate.

Clearly such disclosures are above and beyond those proposed by the Discussion Paper. Accordingly, AFMA submits that entities (or groups of entities) that are listed on an Approved Exchange should be exempted from the disclosure requirements.

Exemption for entities under Annual Compliance Agreements

An Annual Compliance Arrangement (**ACA**) is an ATO compliance product that is available to "key risk" taxpayers. For the purposes of AFMA's submission, it is reasonable to assume that corporate tax entities with a total income in excess of $100 million would represent "key risk" taxpayers and hence be eligible for an ACA.

The ACA framework involves the ATO adopted an assurance based approach to the tax affairs of the entity and requires the ATO to understand the governance processes and risks associated with the entity's taxation affairs. The ATO is able to provide real-time sign-off such that the entity that has entered into the ACA is provided practical certainty as to the taxation outcomes.

Given that under an ACA the ATO is able to "sign-off" on the taxation affairs of the entity and will do so based on a thorough understanding of the taxpayer's affairs and an assessment of the risks of the taxpayer. It would therefore appear appropriate from a policy perspective that such an entity be exempted from having its information disclosed to the public.

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Please contact me if you would like to discuss any aspects of the foregoing.

Yours sincerely

Rob Colquhoun
Director, Policy (Taxation)