Risks to the Sustainability of Australia’s Corporate Tax Base

Scoping Paper
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Foreword

The Government has a responsibility to respond to integrity issues in Australia's corporate tax system. Protecting our corporate tax base will ensure that we have a stable source of revenue to fund vital investments in the future, create a level playing field for businesses and ensures that others will not have to pay disproportionately higher taxes.

The Government's actions demonstrate that it takes this responsibility seriously. The Government has recently enacted amendments to strengthen the General Anti-Avoidance Rule (Part IVA) and modernised Australia's transfer pricing rules. In the 2013-14 Budget, the Government also announced a package of measures to protect the corporate tax base from erosion and loopholes.

As part of this commitment, last year I asked Treasury to prepare a Scoping Paper on the sustainability of Australia's corporate tax base. The paper examines the risks posed by multinational profit shifting and aggressive tax minimisation and identifies potential responses.

The Scoping Paper notes that the preparedness of Governments to respond to integrity issues, the effectiveness of the Australian Taxation Office (ATO) and a strong compliance culture among Australian businesses have helped to sustain Australia's corporate tax base.

However, the paper highlights that data limitations make it difficult to accurately assess the extent to which Australia's corporate tax base is currently being impacted by base erosion and profit shifting. Following on from the Government's recent amendments to increase the tax transparency of large corporate entities, the paper makes a number of recommendations focusing on how we can better identify, understand and respond to emerging risks in our corporate tax system.

A clear finding of the Paper is that global tax settings have failed to keep pace with changes in the global economy. This has, justifiably, led to growing concern around the world that some multinationals, while acting within the law, are taking advantage of outdated international tax laws to reduce the taxation contribution they make to the countries in which they operate.

Updating the rules to address the deficiencies in the tax laws is beyond the scope of any one country acting alone — it requires the cooperation of the international community. With the support of the G20, the OECD has developed an Action Plan to address key pressures in the international tax system, to be implemented in a joint OECD and G20 project.

As G20 chair in 2014, Australia can play a prominent role in determining and driving the base erosion and profit shifting reform agenda.

The preparation of the Scoping Paper has been assisted by a Specialist Reference Group made up of members of business, tax professionals, academics and the community sector. It has also benefited from submissions from stakeholders in response to an Issues Paper. This reflects the fact that there are many groups in Australia that have an interest in the international tax settings within which we operate. I would like to thank all those who have been involved in this process.

A number of the recommendations in the paper are focused on increasing awareness of the risks facing Australia's corporate tax system and the paper highlights that the OECD and G20 have established liaison groups to bring business, academic and civil society contributions into policy considerations. I would therefore also like to encourage all interested groups to remain engaged and involved in these issues as international momentum for change in this area builds.

The Hon David Bradbury MP Assistant Treasurer

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Executive summary

Corporate income tax is an important part of Australia's tax base. This means that Australia has a strong interest in monitoring and, where necessary acting on, developments that pose a risk to the sustainability of its corporate tax base.

In December 2012 the Assistant Treasurer asked the Treasury to examine the risks to the sustainability of Australia's corporate tax base from the way current international tax rules are able to be used to minimise or escape taxation.

In February 2013, an OECD report *Addressing Base Erosion and Profit Shifting* concluded that the corporate tax bases of national governments were at serious risk of erosion reflecting, among other things, that 'current international tax standards may not have kept pace with changes in global business practices' and 'the tax practices of some multinational companies' (OECD, 2013, pp. 6-7).

In May 2013, Treasury released an Issues Paper for public consultation outlining the challenges that changes in the global economy pose to the international tax system. The paper sought views on the extent and nature of these challenges for Australia.

The purpose of this Scoping Paper is to set out the Treasury's assessment of the risks facing Australia's corporate tax system, analyse a broad range of possible policy options to address these risks; and make findings and recommendations. It is also intended that the paper serve as a platform to promote further public discussion and engagement on these issues.

The Scoping Paper first sets out a framework to analyse the risks to the sustainability of Australia's corporate tax base. The framework is used to assess business taxation in general and what should fall within Australia's jurisdiction to tax.

The framework is generally found to work well, but in relation to the digital economy Australia may not be best served by relying solely on the traditional concepts of source, residence and permanent establishment.

The Scoping Paper briefly summarises the history of company income tax in Australia, including the evolution of Australia's international tax policy settings and how this compares with international trends.

In order to assess the extent of risk to Australia's corporate tax base — and the possible policy responses to mitigate these risks — the Scoping Paper examines the underlying sources of risk to Australia's tax base. It finds that many of the underlying drivers of risk reflect deeply entrenched features of Australia's corporate tax system and economic and policy developments beyond Australia's borders and/or control.

It then examines the level of risk to Australia's corporate tax base from several perspectives: the extent to which Australia's corporate tax base is currently being affected by base erosion and profit shifting; the extent of the risk that has been identified internationally; and how the risks to Australia's corporate tax base may be changing over time by assessing trends in the underlying sources of risks.

The Scoping Paper notes the view in submissions on the Issues Paper that there was relatively little evidence of widespread erosion of Australia's corporate tax base at present from tax minimisation activity by multinational enterprises. While data limitations make it difficult to be definitive, this reflects, amongst other things, actions by successive governments to ensure the integrity of Australia's tax laws, the relative effectiveness of the ATO in enforcing corporate tax law, and the good compliance behaviour of companies.

Nevertheless it finds that the failure of international tax rules to keep pace with changes in the global business environment poses a significant risk to Australia's corporate tax base over time if it is not addressed.

In particular, the Scoping Paper notes that there is general agreement that the rise of the digital economy and the increased importance of intangibles present challenges to the corporate tax bases of countries generally, including Australia.

More broadly, erosion of corporate tax bases raises important global issues and addressing these issues is beyond the ability of any one country acting alone. It is therefore important that Australia's interests are prosecuted through multilateral forums.

The Scoping Paper recommends that the focus of Australia's policy response to the risk of corporate tax base erosion be in shaping and leading efforts to improve multilateral reform, with domestic action primarily focused on identifying and taking action against emerging risks that are identified where such action can be taken within existing international frameworks — such as the measures announced in the 2013-14 Budget to protect the integrity of the corporate tax base.

The proposed joint OECD and G20 project to implement a 15 point Action Plan represents an opportunity to make significant progress in modernising global multilateral tax arrangements.

As G20 chair in 2014, Australia can play a prominent role in determining and driving this reform agenda.

1. Introduction

1. Corporate income tax is an important part of Australia's tax base. In 2011-12, Australia had corporate tax receipts of $66.6 billion, or 4.5 per cent of Gross Domestic Product (GDP) and 22 per cent of total federal tax receipts. In addition to the revenue it raises directly, corporate income tax plays an important role in maintaining the integrity of the income tax system generally.

2. Australia collects more corporate tax as a share of GDP than most other OECD countries, despite having a lower statutory tax rate than the OECD weighted average. This reflects the relatively capital intensive nature of the Australian economy, the consistently strong emphasis placed in Australian tax policy and administration on ensuring the integrity of the corporate tax base, and the incentives corporate taxpayers face under Australia's dividend imputation system. However, a relatively small number of companies account for most corporate tax receipts.

3. This means that Australia has a strong interest in monitoring and, where necessary acting on, developments that pose a risk to the sustainability of its corporate tax base.

4. For some time public finance theorists have challenged the ability of national governments to sustain their corporate tax base as globalisation increased the mobility of capital.[1] This thinking is reflected in Australia's Future Tax System (AFTS).[2] More recently, an OECD report *Addressing Base Erosion and Profit Shifting* concluded that the corporate tax bases of national governments were at serious risk of erosion reflecting, among other things 'the tax practices of some multinational companies' and that 'current international tax standards may not have kept pace with changes in global business practices' (OECD, 2013, p. 6–7).

5. In this context, last year the Government asked the Treasury to examine the risks to the sustainability of Australia's corporate tax base from the way current international tax rules are able to be used to minimise or escape taxation. This analysis has benefited from comments by a specialist reference group, made up of members of business, tax professionals, academics and the community sector.

6. In May 2013, Treasury released an Issues Paper outlining the challenges that changes in the global economy pose to the international tax system and sought the views of stakeholders and the community more broadly on the extent and nature of these challenges. In total, 28 submissions were received on the Issues Paper, the main themes of which are summarised in Appendix C.

7. The purpose of this Scoping Paper is to set out the Treasury's view of the risks facing Australia's corporate tax system, analyse a broad range of possible policy options to address these risks, and make findings and recommendations.

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[1] See, for example, (Gordon, 1986), (Gordon, et al., 1994); (Devereux & Sørensen, 2006), (Auerbach, 1982), (Auerbach, 2012), (Sørensen, 2007).

[2] This is reflected Recommendation 27 of AFTS.

8. The Paper first sets out a framework to analyse the risks to the sustainability of Australia's corporate tax base, before outlining the development of Australia's corporate tax system and the approach taken to international tax issues to date. The Paper then analyses both the sources and the levels of risk faced by Australia's corporate tax system and then discuss different approaches to addressing these risks. The Paper sets out the issues for Australia's international engagement on progressing multilateral tax reform before concluding with recommendations.

2. Framework for Analysis

9. In order to properly assess, and develop policy responses to, the risks to the sustainability of Australia's corporate tax base from exploitation of international tax rules, it is necessary to have a framework for assessing business taxation in general. This can guide an understanding of what should, and should not, fall within Australia's jurisdiction to tax.

10. This chapter considers the benchmarks for assessing business tax including those discussed in the significant reviews that have examined business tax settings in Australia over the past four decades. The chapter goes on to examine the frameworks underpinning Australia's jurisdiction to tax and the enabling concepts used to give effect to those frameworks.

2.1 Benchmarks for Assessing Business Taxation

11. Australia's business tax system has been the subject of a number of major reviews over recent decades, including the 1975 report of the Taxation Review Committee chaired by Justice Ken Asprey (the Asprey Report), the 1985 White Paper on Taxation, the 1999 Review of Business Taxation chaired by John Ralph (the Ralph Review), and the 2009 AFTS review.

12. Each of these reviews included discussion and analysis on the appropriate benchmarks or frameworks for thinking about the tax system generally and, in some cases, the business tax system in particular. Notwithstanding some points of difference in detail and emphasis, there has been a striking level of agreement around the three benchmarks set out in the Asprey Report: equity, economic efficiency and simplicity (Asprey, 1975). The Ralph Review highlighted the importance of ensuring the dynamic robustness of the tax system, including the ability to accommodate changes in the business environment (Review of Business Taxation, 1998). The AFTS review also emphasised the sustainability of the tax system and the importance of policy consistency, the idea that 'rules in one part of the system should not contradict those in another part of the system'.[3]

13. The benchmark of economic efficiency is often used interchangeably with the objective of optimising economic growth. A key principle in achieving this benchmark is neutrality: limiting the extent to which the tax system affects economic choices. This is important given all taxes create a drag on economic efficiency, which results in a key objective of tax policy being to impose taxes in such a way as to minimise the adverse impact on economic activity.

14. In an international context, a key conceptual challenge is determining the appropriate comparator for neutrality. Capital export neutrality aims for neutrality in international investment decisions. It is achieved where an investor from a particular

[3] While framed in the context of the AFTS discussion on interactions between the tax and transfer system, it is equally applicable in relation to when thinking, for instance, about international tax settings and other aspects of international trade policy.

country faces the same effective tax rate on an investment regardless of the country of investment. Capital import neutrality is achieved when an investment has the same effective tax rate (and therefore after-tax return) for both domestic and foreign investors. For capital import and capital export neutrality frameworks to work optimally, every jurisdiction would need to have the same tax base and the same rate. Given this is unrealistic these concepts serve as a benchmark rather than a practical goal.

15. In most cases it is not possible to simultaneously achieve capital import and export neutrality, requiring a choice to be made between the benchmarks. The Ralph Review described this as a 'dynamic balancing act', concluding that:

> Australia must ensure that its international tax arrangements attract desirable inbound investment, do not detract from the incentives Australian entities have to remain domiciled here, recover an appropriate return from both inbound and outbound investment, and further the competitiveness of the economy generally.
>
> (Review of Business Taxation, 1998, p. 77)

2.2. Australia's Jurisdiction to Tax

16. An analysis of the risk of the erosion of Australia's corporate tax base from base erosion and profit shifting activity by multinational enterprises requires a sound conceptual framework setting out what should, and should not, properly fall within Australia's jurisdiction to tax. This is a separate question of what currently is, or could be, within the jurisdiction to tax.

17. Historically, the most influential conceptual frameworks underpinning the division of taxing rights between countries have been the benefit doctrine and the economic allegiance doctrine. The benefit doctrine bases a country's claim to the taxation of residents and non-residents on the use of benefits provided by the country, while the economic allegiance doctrine bases taxation rights on the existence and extent of the economic relationships between the country and the income or person concerned. Given the nature and shape of the economy in the early twentieth century, in the majority of instances the economic allegiance and benefits doctrine would have yielded very similar conclusions on countries' jurisdiction to tax.

18. While there have been significant changes in the global economy since these doctrines were first developed, they continue to articulate the nature of relationships between a jurisdiction and economic activity and therefore remain relevant, encompassing the conceptual case for claiming taxing rights. However, a key issue is whether the economic allegiance doctrine and benefits doctrine give the same conclusions on jurisdiction to tax where the location of economic activity is unclear. If not, the challenge is to determine which doctrine should have primacy.

19. Countries can assert the right to tax to the limit of their sovereignty. There are two aspects of a country's sovereignty: the people (its citizens and residents) and territory it claims authority over. Traditionally, the application of the economic allegiance and benefits doctrine, combined with the practical limits on countries' ability to assert sovereignty, gave rise to the two concepts that underpin the

international framework for the taxation of cross-border income and capital: the residence (of individuals and entities) and the source (of income).

20. A related issue then is whether the concepts of source and residence continue to represent a reasonable proxy for the economic allegiance and benefit doctrines in the modern economy. In particular, it is arguable in relation to the digital economy and the broader knowledge economy that the concepts of source and residence may no longer adequately reflect the economic allegiance and benefits doctrine. That is, it is important not to lose sight of the fact that ‘source’, ‘residence’ and ‘permanent establishment’ are the tools for allocating taxing rights rather than the guiding conceptual frameworks.

21. The concept of ‘permanent establishment’ draws on elements of the concepts of ‘source’ and ‘residence’. It seeks to treat part of an entity as a resident when it has a significant physical presence in a jurisdiction. Business profits of a permanent establishment are then effectively deemed to have a source in that jurisdiction.

3. Corporate and International Income Tax in Australia

22. Before assessing the risks to the sustainability of the corporate income tax base, and possible policy responses, it is useful to consider why we have a company income tax in the first place, and how that can operate in an international environment.

23. With this in mind, this section briefly summarises the history of company income tax in Australia, including the evolution of international taxation of corporate income and how this compares with international trends.

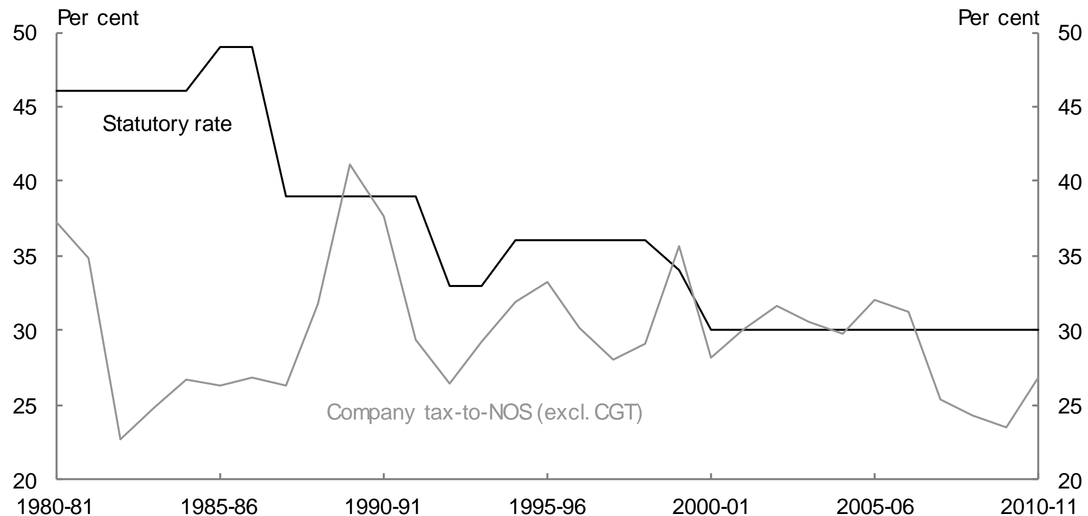
3.1 Australian Corporate Tax Reform: Broaden Base, Lower Rate

24. The Asprey Report generally endorsed the view that it was fairer to impose taxation on income earned by companies at the shareholder rather than company level. However, the report concluded that a key rationale for the taxation of income at the company level was that 'in the absence of company tax, shareholders would be taxed inadequately' (Asprey, 1975, p. 224). In addition to the issue of retained earnings, the Asprey Report found that an 'extremely important' rationale for company income tax was that it:

> provides one of the few available means — from the revenue point of view certainly the most significant means — of levying tax on foreign residents deriving income from operations in Australia.
>
> (Asprey, 1975, p. 225)

25. A key policy theme from the Asprey Report was the need to improve the efficiency of Australia's income tax system by broadening the base to which taxes applied and lowering the statutory rate. The reduction in Australia's company income tax rate from 46 per cent in the mid-1980s to the current rate of 30 per cent reflects this approach, with the reduction in the statutory rate accompanied by the removal of a number of business tax concessions. The net result of this approach is that the average effective rate of company tax has been broadly stable in Australia over recent decades (Chart 1).

Chart 1: Statutory company tax rate and average company tax rate over time



Source: Treasury.

26. A similar trend is evident across OECD countries. Company income tax rates have fallen considerably across the OECD in recent decades (Chart 2), with a broadening of the company tax base. The net effect is that company tax revenues as a share of GDP have slightly increased across the OECD over the past three decades, despite headline company tax rates declining (see Chart 3).

Chart 2: Company tax rates (1982-2012)

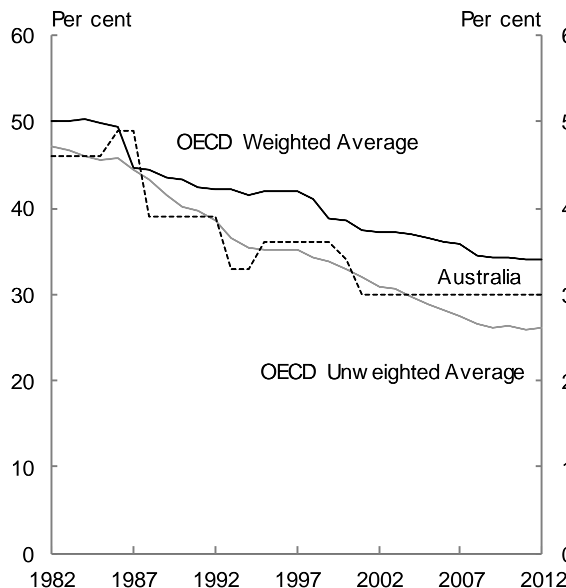
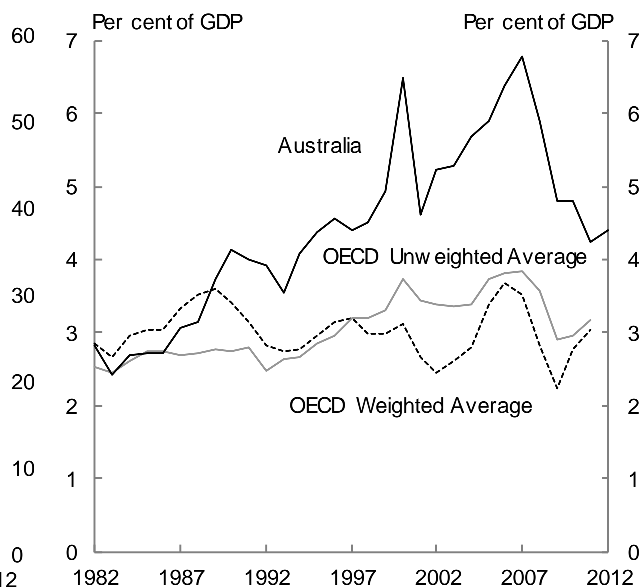


Chart 3: Company tax revenues as a share of GDP (1982-2012)



Note: Sourced OECD 2009 for OECD data from 1982-2009, OECD 2012 for OECD data from 2010-2011. Economic weights for 2010 have been used for 2011 due to data limitations. Australian data for 2011 and 2012 uses an averaged fiscal year rather than calendar year figure. Australia data to 2012, OECD countries to 2011.

27. The rationale for the broad base, low rate approach is that a corporate tax system that applies equally across companies and sectors is more efficient, fairer and ultimately more sustainable. In contrast, anomalies in corporate tax laws typically result in an unpredictable and uneven tax burden across industries and across companies within industries distorting investment decisions, providing unfair

competitive advantage to some companies over others and undermining confidence in the tax system and compliance with the tax law.

28. The report of the AFTS review endorsed the retention of a broad-based business income tax (AFTS, 2009, p. 25). Moreover, the Report found that economic efficiency would be enhanced if Australia shifted its tax mix away from mobile factors of production (capital, excluding land and natural resources) and towards less mobile factors of production (land, natural resources and labour).

29. The AFTS report found that Australia's company income tax rate of 30 per cent was above the average rate for small to medium OECD economies of 25 per cent. The AFTS report recognised the need to balance the benefits of a lower corporate tax rate in attracting mobile factors of production against the implications for the personal income tax and the taxation of less mobile capital. It recommended that Australia's company income tax rate be reduced to 25 per cent over the short to medium term, subject to economic and fiscal circumstances and the imposition of improved arrangements for charging for the use of non-renewable resources.

30. In 2011, the Government established the Business Tax Working Group (BTWG) to consider how the business tax system could be improved to make the most of challenges and opportunities arising from the transformations in the broader Australian economy, including the desirability of a cut in the company tax rate accompanied by measures to fully offset the cost. The final report of the BTWG found that 'the business tax base is broader than it was in the 1980s and 1990s and significant savings are now more difficult to identify and reach consensus on'.

3.2 Australia's Approach to International Tax

31. Countries exercise their tax jurisdiction based on either a worldwide or a territorial approach — or on a combination of both. Under the **worldwide** tax approach, a country exercises its sovereign power to tax the income derived by its *residents* from anywhere in the world, and over income derived by foreign residents from within its borders. Under the **territorial** tax approach, a country limits its sovereign power to tax to earnings *sourced* from within its geographic borders.

32. When income tax was first imposed in Australia a strict territorial approach was adopted: only income with an Australian source was taxed in Australia.[4] In subsequent decades, the direction of reform was towards a worldwide system of taxation, with foreign source income of Australian residents being subject to tax, and withholding taxes imposed on dividends, royalties and interest.

33. The peak of the trend towards the worldwide approach in Australia was the introduction of the Foreign Tax Credit System from the 1987-88 year of income. Under this system, foreign source income of Australian resident individuals and companies was subject to income tax in Australia, with credit allowed for foreign tax paid (up to the amount of Australian taxation).

[4] Among Australian's first set of tax measures unrelated to excise or customs duties were the broad-based land taxes introduced in the *Land Tax Act 1910* and the *Land Tax Assessment Act 1910*. See, for instance, the Australian Taxation Office (2010, pp. 17-20).

34. Following the Ralph Review and the Review of International Taxation ('RITA') in 2002, the direction of reform has progressively shifted back to a territorial tax approach for the active income of business. In addition to concerns with the complexity of the foreign tax credit system, a key goal of these changes was to allow Australian-based multinational enterprises operating in other countries to have the same tax treatment as their competitors in those markets.[5]

35. The net result over time of these changes is that Australia generally applies a worldwide tax approach to individuals and 'passive' business income and a territorial tax approach in relation to 'active' business income earned overseas by Australian resident companies. In effect, 'active' business income earned overseas by a company controlled by an Australian company is generally exempt from tax in Australia (irrespective of whether it is subject to tax overseas).

36. Australia's move towards a territorial tax system for active business income is consistent with the general trend away from a worldwide taxation model by OECD member countries. With the recent move towards a territorial approach by the United Kingdom and Japan, the United States remains the only major economy in the OECD that adopts a worldwide taxation principle for corporate taxation.

37. Throughout the evolution of the jurisdiction to tax policy, Australia has had rules in place to protect the ability of Australia to exercise its jurisdiction to tax, with these rules being enforced robustly and consistently by tax authorities. In particular, Australia has a long history of actively enforcing 'transfer pricing' provisions to address the challenge of how to ensure that appropriate valuations apply to cross-border transactions and 'thin capitalisation' rules to address profit shifting through the excessive allocation of debt to Australia.

---

5 That is, Capital Import Neutrality.

4. Sources of Risk to Australia's Corporate Tax Base

38. In order to assess the extent of risk to Australia's corporate tax base — and the possible policy responses to mitigate these risks — it is important to understand the underlying sources of risk to Australia's tax base. In particular, many of the underlying drivers of risk reflect either deeply entrenched features of Australia's corporate tax system or economic and policy developments beyond Australia's borders and/or control.

4.1 Entrenched Structural Features of the Corporate Tax System

39. Australia's corporate tax system does not operate in a vacuum, but reflects the commercial, legal and international environment within which it operates. Key structural features of the corporate tax system can act as a practical constraint on the capacity of Australia's tax law to respond to emerging pressures and risks.

4.1.1 Non-Economic Distinctions in Tax System Design

40. In the context of the US system, Edward Kleinbard referred to 'four non-economic axioms' that lay at the core of the system of taxing capital: debt/equity; corporate/non-corporate enterprises; capital gain/ordinary income; and the realisation principle. These distinctions are also reflected within the Australian corporate tax system.[6]

41. There are reasons for these distinctions and they can be entrenched in commercial practice. Further, in some cases clear distinctions can be drawn between the economic substance of arrangements in different categories. However, at the margin there can be little, if any, economic difference between them.

42. Wherever the tax system provides significantly different treatment to instruments or transactions that are substantially the same, tax planning and arbitrage opportunities will arise. As the Ralph Review noted:

> Economic transactions should be taxed on the basis of their economic substance — not their legal form.
>
> (Review of Business Taxation, 1999, p. 78)

4.1.2 Tax Treaties

43. The principal mechanism for the division of taxing rights between countries is bilateral tax treaties. Australia's 44 tax treaties are broadly in line with the OECD Model Tax Convention (OECD Model Treaty). The structure of the OECD Model Treaty is essentially the same as the structure developed in the 1920s.

[6] Distinctions that could arguably be added to this list in an Australian context include portfolio/non-portfolio investments and active/passive income.

44. Tax treaties seek to encourage economic activity by providing for fair, certain and efficient tax treatment of cross-border trade and investment, by preventing double taxation and tax discrimination against foreign investment and allowing tax administrators to share tax information in order to prevent evasion.

45. A defining feature of tax treaties is that they are agreements by which countries voluntarily restrict their sovereign right to impose tax. Australia's tax treaties, consistent with the OECD Model Treaty, limit Australia's right to tax business profits. For example, foreign residents are generally only taxable on business profits to the extent they are attributable to a permanent establishment located in Australia. Australia's tax treaties also typically include provision for the reciprocal reduction in withholding taxes on interest, dividends and royalties payments to residents of treaty partner countries.

46. When restricting Australia's taxing rights Australia's tax treaties implicitly assume that tax treaty partner countries will effectively enforce their right to tax (and hence have a tax treatment broadly equivalent to what would apply in Australia). In these circumstances, there is much less incentive to engage in profit shifting activity. However, where a tax treaty partner is not fully exercising its right to tax this can be considered as equivalent to having a tax treaty with a tax haven. As such, gaps, mismatches and inconsistencies in tax rules of treaty partner countries can pose risks to the integrity of Australia's corporate tax system.

47. Tax treaties typically include 'transfer pricing' rules to address the challenge of how to ensure that appropriate valuations apply to cross-border transactions, particularly where they involve related parties. In theory, much of the risk of profit shifting by multinational enterprises could be eliminated by fully effective transfer pricing rules. However, there are often considerable practical and conceptual difficulties in objectively arriving at a unique valuation for many transactions. Inevitably, there is a range of possible valuations, which provide opportunities for profit shifting and this is a significant source of disputes both between multinational enterprises and tax authorities, and between the tax authorities of different countries.

48. By design, it is not easy to amend or update an international treaty. Australia's tax treaties are binding international agreements that are incorporated into domestic tax law. As such, and consistent with other international treaties entered into by Australia, tax treaties are subject to a national interest assessment by the Joint Standing Committee on Treaties before any action is taken to ratify them. Australia's tax treaties do not have a sunset clause, but remain in place indefinitely and only in rare cases require periodic review of their effectiveness.

49. In practice, this means that if circumstances change so that a tax treaty delivers inappropriate outcomes, Australia is restricted in what it can do in response, short of the often lengthy process of renegotiating the tax treaty with the partner country. Further, if a partner country does not agree to update or amend a tax treaty then the choice is between retaining a treaty that delivers inappropriate outcomes or the extreme option of unilaterally cancelling or suspending the whole treaty, on the grounds that it is no longer in the national interest. This would usually require evidence that the tax treaty partner itself was in some way complicit in, or indifferent to, the exploitation of the treaty and may require the giving of notice of such intention to the treaty partner. Australia has never cancelled a tax treaty and it is very rare for an OECD country to cancel a tax treaty.

4.2 Tax Challenges Posed By a Changing Global Economy

50. Following significant trade liberalisation and widespread financial deregulation, along with dramatic improvements in information and communication technology, recent decades have seen a sharp increase in the level of integration between national economies and a greater number of businesses with cross-border operations. Increasingly multinational enterprises adopt a 'global value chain', with business functions located where they can be undertaken most efficiently for the firm. The growth of global value chains has increased the scale and complexity of international trade and foreign direct investment. In turn, these developments have been an important driver of economic growth in Australia and globally.

51. Moreover, the rise of the digital economy has meant that many transactions and functions that previously relied on a physical proximity with the market can now be undertaken more or less anywhere. This has meant that an increasing proportion of economic activity has become tradable — that is, subject to international competition — resulting in challenges and opportunities for businesses as well as substantial benefits to consumers (Department of Broadband, 2011).

52. These developments in the global economy over recent decades pose a number of risks to the ability of the international tax system to deliver appropriate outcomes for all countries, including Australia.

4.2.1 Rise of the digital economy and the increasing importance of intangibles

53. In the industrial age the bulk of economic activity could be attributed to factors of production — such as labour, land, buildings and structures, and plant and equipment — that had a clear physical location (Productivity Commission, 2011). This is reflected in many of the concepts underpinning the international tax framework — both in Australia and internationally — such as source, permanent establishment and residency that assume that it is possible to objectively determine where economic activity occurs.

54. This assumption is fundamentally challenged by the rise of the digital economy; the increasing importance to production of intangible capital (such as intellectual property, goodwill or 'brand names'), which by its very nature has no physical location; rapid developments in information and communication technology; and, the integration of production in global value chains.

55. The potential for developments in the digital economy to have an adverse impact on Australia's corporate tax base was identified in the ATO's 1997 report *Tax and the Internet* (ATO, 1997). This report was prepared to stimulate discussion of the key issues, particularly at the Joint Committee of Public Accounts and Audits, whose inquiry into electronic commerce led to the publication of its findings in its 1998 *Report 360: Internet commerce — to buy or not to buy?* The nature and extent of those risks have shifted as the digital economy itself has evolved, and the international tax system has not adjusted sufficiently to reflect this.

56. To date, attempts to adjust the international tax system to accommodate the changes in the global economy have sought to 'shoehorn' these developments to fit within the existing industrial age concepts. For example, taxing rights in relation to e-commerce have been assessed by providing updated guidance on the concept of

permanent establishment to, in some cases, extend beyond requiring a physical presence in a country.

57. However, there are serious questions over both the appropriateness of the results produced, and the longer term sustainability of this approach. In particular, the 'arm's length principle' that traditionally underpins transfer pricing rules is very difficult to apply to transactions that would never happen between unrelated parties or in an open, competitive market (such as dealings in unfinished products, proprietary knowledge and information). As the OECD has observed:

> A key issue is whether tax concepts developed for the industrial age can be made to work in the era of the digital economy.
>
> Current international tax standards may not have kept pace with changes in global business practices, in particular in the area of intangibles and the development of the digital economy.
>
> (OECD, 2013, p. 7)

4.2.2 The global reach of multinational enterprises

58. The global reach of multinational enterprises, along with the developments in information and communication technology and close integration of global financial markets, provides them with a high degree of flexibility in how to structure their affairs. Increasingly multinational enterprises operate as a single economic entity, rather than a collection of related separate entities.

59. This means that multinational enterprises can be well positioned to structure their intra-group dealings in particular ways where there is a tax advantage in doing so (OECD, 2013, pp. 5-6). For example, mismatches in the tax treatment of economically equivalent items within or between jurisdictions give rise to tax arbitrage opportunities. For example, where a financial instrument has features of both debt and equity it is possible that it would be treated as debt for tax purposes in one country and equity in another. Tax arbitrage arrangements can exploit these mismatches, in some cases resulting in a net tax loss where there is no net economic outgoing.

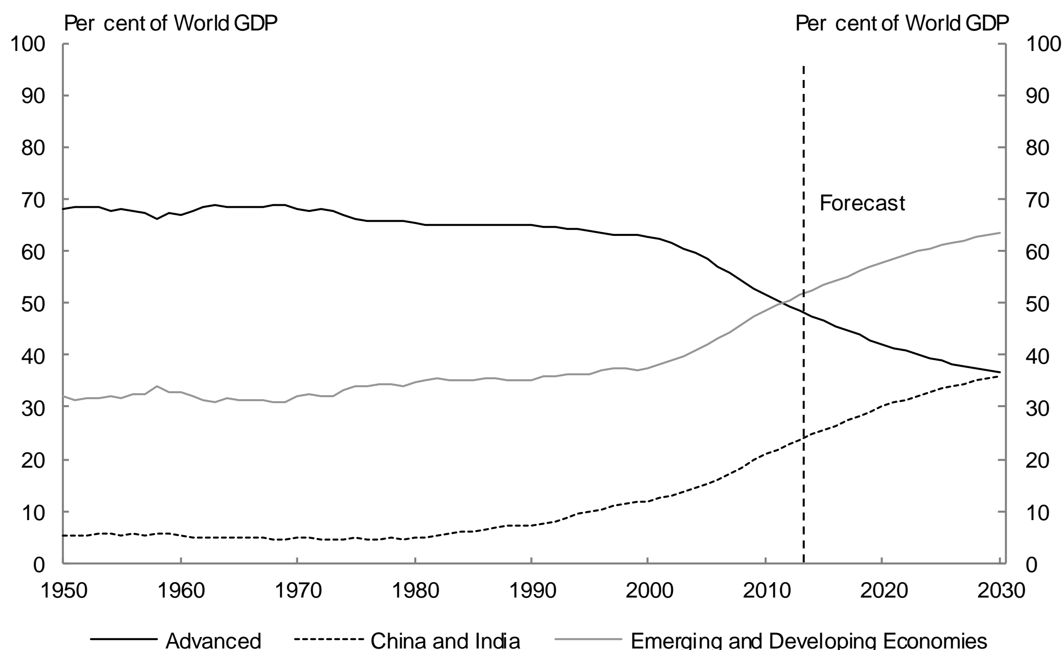
60. Multinational enterprises typically have flexibility in how they arrange their capital structure and so can locate debt (and therefore their interest deductions) in profitable parts of the group, reducing the global tax on their business profits. Where a group finance company is located in a low-tax country the resultant interest income would be taxed favourably (or sometimes not at all), resulting in a reduction in the total tax paid by the group as a whole. The OECD has noted that the tax treatment of debt means that 'leveraging high-tax group companies with intra-group debt is a very simple and straightforward way to achieve tax savings at group level' (OECD, 2013, p. 43).

4.2.3 Changing composition of global economic activity

61. The current international tax rules were put in place when OECD countries represented the majority of global economic activity. However, growing diversity and changes in the composition of the global economy has implications for the sustainability of these rules.

62. The growing integration of the global economy has been an important contributor to the rapid economic growth of emerging market economies generally. In particular, the 'rise of Asia' will be a defining feature of the 21st Century and will have profound global implications, including as a result of the composition of world economic activity (Chart 4).

Chart 4: Share of Global Economic Output

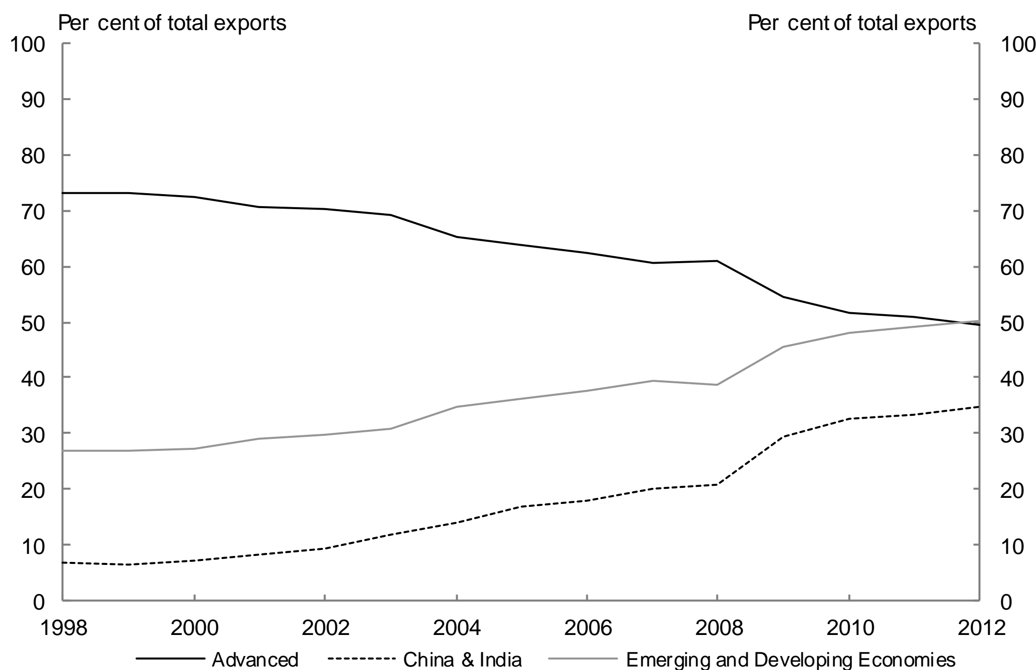


Source: Au-Yeung W, Kouparitsas M, Luu N, Sharma D, (2013 forthcoming) Long-term international GDP projections, Treasury Working Paper.
Note: Groupings are based on the International Monetary Fund World Economic Outlook aggregations. Emerging and Developing Economies includes China and India.

63. Emerging market economies have increased from representing around 30 per cent of world economic activity in the mid-twentieth century to about half today, with this share expected to continue to rise to around 60 per cent by the middle of the next decade. Among other things, this shift in relative economic weight between advanced economies and emerging market economies has important geopolitical implications, including for the sustainability of the current international tax rules and institutions.

64. The changing nature of the global economy is also evident in the composition of Australia's trading partners. These significant geographic shifts in global economic output are similarly reflected in the composition of Australia's trading partners. Over the past decade, China's share of Australia's merchandise exports increased more than four-fold, from 5 per cent to over 20 per cent (Chart 5). The International Monetary Fund projects that by 2015, China will receive around one third of Australia's merchandise exports and India will receive more than one tenth of Australia's merchandise exports, up from just 2 per cent at the start of this century (Sun, 2010). Overall, since 1998, emerging and developing market economies have gone from receiving less than one-third of Australia's merchandise exports to over half by 2012.

Chart 5: Australia's merchandise export destinations



Source: ABS Cat. No. 5432.0.

4.3 Tax Policy responses of other countries

65. Australia's corporate tax base can also be affected by tax policy responses of other countries. Globalisation has increased tax competition between countries. This has several dimensions. Tax competition can be either beneficial or harmful. Countries that operate as 'secrecy jurisdictions' can facilitate tax evasion by companies by enabling them to obscure the level, character and ownership of income and assets from tax authorities. Globalisation has also resulted in increased trade and investment between countries that may have inconsistent approaches to the tax treatment of cross border transactions.

4.3.1 Globalisation and Tax Competition

66. The potential for tax competition between countries to erode corporate tax bases has long been recognised.[7] The AFTS report concluded that:

> In a world of increased capital mobility, company income tax and other taxes on investment have a major impact on decisions by businesses on where to invest, how much and what to invest in and where to record their profits.
>
> (AFTS, 2009, p. 149)

67. There are two related but distinct elements to this argument. The first is that countries can engage in competition on corporate tax in order to attract increasingly mobile capital. There is a longstanding, widely held view in public finance that the sustainability of the corporate tax bases of national governments was likely to erode

[7] The Ralph Review noted that 'competition among countries for taxation revenue poses a significant threat to national revenue bases and effective tax rates'.

over time, as national governments reduced tax rates in order to attract increasingly mobile investment.[8] The Ralph Review argued that 'the continuing globalisation of the world economy means that international competition for resources, particularly capital, is intensifying' (Review of Business Taxation, 1999, p. 23).

68. The second element is that the highly mobile nature of some sources of income (including returns on intangible assets and financing transactions) provides an incentive for individual countries to try to use a low rate of taxation to induce that income to be reported in their jurisdiction.

69. There is a clear distinction between policies aimed at attracting economic activity and the *reporting* of that activity.

70. One perspective is that the increased mobility of capital associated with globalisation suggests, on the grounds of economic efficiency, a relative switch in the tax mix of countries away from capital taxation and towards other, less mobile, factors of production may be warranted.[9] This point is made in the AFTS report (AFTS, 2009, p. 149. Vol 1). Importantly, the efficiency of the tax mix is a different question to the overall level of taxation and thus the size of Government. Investment decisions rest not only on the imposition and incidence of tax, but also on the broader economic environment within the country which among other things will reflect the overall efficiency of the provision of government goods and services (Cashin, 1995), (Tax Justice Network, 2013).

71. The other perspective is that the competitive pressure from globalisation restricts the ability of national governments to raise tax revenue. Those concerned with this outcome emphasise the impact this has on the ability of national governments to provide goods and services that would improve the welfare of their citizens (Devereux, et al., 2002). On the other hand, there is a strong view that by imposing a more immediate recognisable cost on government expenditure, tax competition from globalisation imposes a discipline on both the overall size of national governments, as well as placing the onus on them to provide those goods and services as efficiently as possible (Brennan & Buchanan, 1980).

72. Conceptually, there is a difference between this type of 'beneficial tax competition' and 'harmful tax competition', where countries use favourable tax treatment to induce multinational enterprises to account for that income in their jurisdiction, without a commensurate shift in real economic activity. Of particular concern in this context are 'mobile rents' (Devereux & Sørensen, 2006), such as returns from intellectual property, where the country in which the income is reported for taxation purposes can be different from that in which the rent was created (Auerbach, 1982).[10]

73. There are two key problems caused by harmful tax competition. First, national governments who efficiently provide goods and services that support the creation of such mobile rents would not receive a return through the income tax system, leading to an under provision of government goods and services. Second, national governments could benefit from the creation of these mobile rents without having to

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[8] See, for example, Sørensen (2007).

[9] See, for example, Gordon (1986).

[10] Although it should be noted that the transfer of intellectual property developed in one jurisdiction to another could itself have tax consequences.

provide goods and services that support them, allowing them to offer much lower rates of taxation to this type of income.

74. The potential for harmful tax competition, particularly between tax treaty countries, to erode the tax base of countries has long been recognised. However, in practice it can be very difficult to distinguish between beneficial and harmful tax regimes. That is, what one country may view as a legitimate policy setting to attract investment another country may view as harmfully diverting the reporting of income for tax purposes from real economic activity in its jurisdiction.

4.3.2 Secrecy Jurisdictions

75. Historically, the laws in some countries have imposed strict rules protecting the secrecy of investments within that jurisdiction. Since the introduction of income tax, well-resourced individuals and multinational enterprises have sought to exploit these rules to evade their obligations under the tax laws of national governments. In addition to simply hiding income, 'secrecy jurisdictions' can enable the nature of financial flows to be disguised or misrepresented, and the beneficial ownership of assets to be obscured.

76. While tax authorities typically have wide-ranging powers to gather information for tax purposes (OECD, 2012), there are practical difficulties and legal limits on the ability of national tax authorities to obtain information outside their jurisdiction. Despite significant progress in recent years in fostering greater international co-operation to improve transparency and exchange of information for tax purposes, the potential for 'secrecy jurisdictions' to be used to evade tax properly paid in Australia remains. In addition the peer review process of the Global Forum for Transparency and Exchange of Information for Tax Purposes[11] which began in 2009 is not expected to be completed until the second half of 2013.

4.3.3 Inconsistent Approaches to Cross-Border Transactions

77. In many countries there is growing concern that the current consensus on international tax rules, usually implemented through a network of bilateral treaties, is not resulting in appropriate tax outcomes for national governments, in particular due to profit shifting practices of multinational enterprises. While ideally these concerns would be addressed through multilateral efforts to update international tax rules, there is a risk that countries may instead act unilaterally, outside of the current consensus, in order to achieve what they see as more appropriate tax outcomes.

78. As the OECD has indicated, such 'unilateral and uncoordinated actions by governments responding in isolation' would bring with it an increased risk of double taxation, damaging cross-border trade and investment. From an Australian perspective, the implementation of such measures by other jurisdictions would either increase the risk of double taxation or result in a reduction of Australia's corporate tax base.

[11] The Global Forum is the continuation of a forum which was created in the early 2000s in the context of the OECD's work to address the risks to tax compliance posed by tax havens.

5. Level of Risk to Australia's Corporate Tax Base

79. One aspect of the risk to Australia's corporate tax base is the extent to which it is currently being affected by base erosion and profit shifting. The May 2013 Issues Paper examined this question, and sought submissions on whether there was evidence of base erosion and profit shifting in Australia, including what additional data might be required to reach a definitive conclusion.

80. It is also important to clearly understand the extent of the risk that has been identified internationally. This is because international trends may highlight actual or potential risks to the Australian corporate tax system and because it may explain actions that are or will be undertaken by the international community in this area.

81. Perhaps even more important is the question of how the risks to Australia's corporate tax base may have changed (and may be changing) over time. Broadly, this requires an assessment of trends in the sources of risks identified in the previous Chapter, and how they are changing over time, and the effectiveness of measures taken domestically and internationally to mitigate these risks.

5.1 Evidence of Base Erosion and Profit Shifting in Australia

82. The Issues Paper noted that a significant conceptual challenge in assessing the level of erosion of the corporate tax base was establishing a relevant benchmark. While a common approach is to analyse aggregate trends in corporate tax collections, it is difficult to isolate the impact of tax planning strategies from other factors. The usefulness of analysis of effective tax rates of companies is limited by the potential for profit shifting to affect both tax and accounting income and the need to isolate the impact of policy decisions on the tax base. More detailed data on specific areas of risk of base erosion could provide a more useful indicator of the emergence of risk over time, but data limitations mean that it can be difficult to extrapolate from available data to draw conclusions on the aggregate extent of the issue.

83. Submissions on the Issues Paper from business representatives and the tax profession generally expressed the view that there was little evidence of widespread erosion of the Australian corporate tax base from tax minimisation activity by multinational enterprises.[12] A number of submissions made similar points to this statement by the American Chamber of Commerce in Australia:[13]

> Australia is very well known internationally as having a highly effective set of tax laws to protect Australian Revenue. The ATO is widely known as being one of the more effective and skilful tax administrations within the members of the OECD.

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[12] See for example submissions by PriceWaterhouseCoopers, Ernst &Young and the Tax Institute of Australia, 2013, *Submission to Issues Paper – Implications for the Modern Global Economy for the Taxation of Multinational Enterprises*, May 2013.

[13] American Chamber of Commerce in Australia, 2013, *Response to the Treasury Issues Paper: Implications of the Modern Global Economy for Taxation of Multinational Enterprises*, 6 June 2013, p.2.

84. A number of submissions also highlighted the role of Australia's dividend imputation system in encouraging compliance by Australian listed and owned companies.[14] More generally, the Institute of Chartered Accountants in Australia stated that:[15]

> The prevailing culture within the economy, including multinationals, and society more widely is one of compliance with Australia's tax laws. Tax crime and evasion are at the margins of economic activity.

85. Submissions also generally accepted the arguments in the Issues Paper that effective tax rate calculations were of limited value in assessing the extent of profit shifting by multinational enterprises.

86. There was, however, general agreement that the rise of the digital economy and the increased importance of intangibles presented challenges to the tax base of countries generally, including Australia.

87. The Tax Justice Network attributed the lack of clear evidence of base erosion and profit shifting in Australia to the high level of confidentiality of taxpayer affairs restricting the level of information in the public domain. A consistent message from submissions was that greater use should be made of information currently provided to the ATO before any additional data was sought to address information gaps.

88. In any case, the extent to which Australia's corporate tax base is currently being affected by base erosion and profit shifting is only one aspect of the level of risk to Australia's corporate tax base. As one submission noted 'evidence of the precise extent of BEPS would be helpful but is not essential; the fact that BEPS can occur is enough to justify attempting to set the rules correctly'. [16]

89. The evidence that Australia has one of the more effective corporate tax systems in the OECD means corporate tax has a more important role in Australia's tax system than that of many other countries. As such, efforts to address the risk of base erosion and profit shifting in Australia should primarily focus on protecting the existing corporate tax base.

5.2 International Evidence of Corporate Tax Base Erosion

90. As in the Australian context, the analysis undertaken to date on the available evidence of the magnitude and growth of global corporate tax base erosion is mixed.

91. On the one hand, several submissions on the Issues Paper expressed a similar sentiment to that put by tax academics from the University of New South Wales that

[14] For example, in its submission to the issues paper, Ernst & Young noted that 'Australia's dividend imputation system means that the likelihood of BEPS activity by Australian listed public companies is substantially less than arises in other countries'.

[15] Institute of Chartered Accountants Australia, 2013, *Issues Paper on Implications of the Modern Global Economy for the Taxation of Multinational Enterprises*, 31 May 2013.

[16] See joint submission by John Taylor, Michael Walpole, Kathrin Bain, Dale Baccabella, and Nolan Sharkey, 2013, *Submission to Issues Paper – Implications for the Modern Global Economy for the Taxation of Multinational Enterprises*, May 2013.

pointed to the 'ample evidence that base erosion and profit shifting is occurring internationally' as indicating that this activity would also be present in Australia.[17]

92. However, the OECD report suggests a more cautious interpretation of the existing international evidence (OECD, 2013).

5.2.1 Global Effective Tax Rates of Multinational Enterprises

93. In theory, analysis of the global effective tax rates of multinational enterprises should provide evidence of the extent to which profits had been shifted to low tax jurisdictions. Undertaking these calculations at the global level overcomes a key limitation of country-level effective tax rate analysis — the potential for profit shifting to affect both tax and accounting income.

94. In practice, despite some high-profile examples of low global effective tax rates, the OECD concluded that it is questionable whether estimates of global effective tax rates 'provide conclusive evidence that base erosion and profit shifting behaviours are evident'. A key challenge is that effective tax rate calculations 'conflate a number of factors', including policy decisions of national governments, that make it difficult to isolate the reason for variations in global effective tax rates between companies (OECD, 2013). Another challenge is the significant variation in methodology employed in the literature, making comparisons very difficult.

5.2.2 Patterns of Foreign Direct Investment

95. Patterns of foreign direct investment can also provide evidence of the level of base erosion and profit shifting internationally. Channelling foreign direct investment through low or no tax jurisdictions, or special purpose entities, could be indicative of base erosion and profit shifting activity.

96. International Monetary Fund data on the source and destination of foreign direct investment highlights that the level of foreign direct investment channelled through some low or no tax jurisdictions is vastly disproportionate to their size — and that this investment has not led to any commensurate increase in domestic economic activity (Chart 6). Analysis of the proportion of corporate profits allocated to these jurisdictions presents a similar picture.[18] As Gordon and MacKie-Mason noted:

> Observed investment and profit rates in low-tax countries are almost certainly explained by the ease with which a multinational can shift its accounting profits from high-tax to low-tax jurisdictions.
>
> (Gordon & MacKie-Mason, 1994, p. 68)

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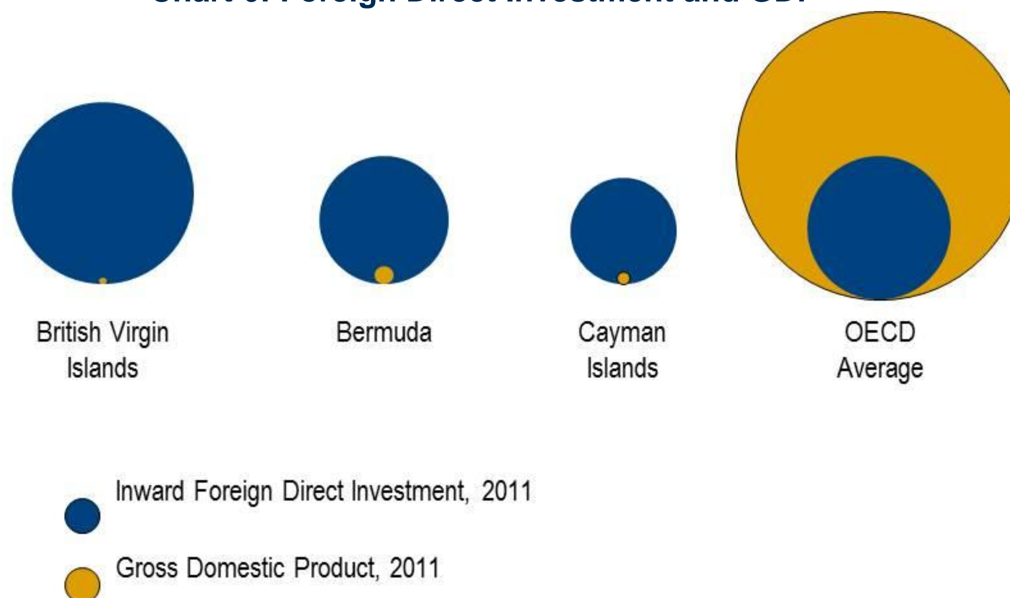
[17] Ibid.

[18] See, for example, (Grevelle, 2013).

Chart 6: Foreign Direct Investment and GDP



97. Nevertheless, the OECD cautions that while the use of these jurisdictions for holding or intra-group financing warrants further examination, it does not of itself necessarily 'imply that they are being used for base erosion and profit shifting' (OECD, 2013).

5.2.3 Corporate Tax Trends in OECD Countries

98. Another potential indicator of base erosion in OECD countries is the relationship of corporate income tax to GDP over time. If base erosion was becoming a larger issue over time then, all else being equal, corporate tax would be expected to decline as a share of GDP over time. However, the OECD observes that the unweighted average of revenues from corporate income tax as a share of GDP has generally been rising over time, despite statutory corporate tax rates falling across the OECD (Sørensen, 2007).

99. An important caveat on this analysis is that it does not control for several factors that could obscure any impact from base erosion and profit shifting. In particular, the share of GDP attributable to corporate profits has been rising over time in many OECD countries, and corporate tax bases have been broadened as 'tax expenditures' have been reduced.

100. Overall, the view that corporate income tax collections would inevitably decline over time in response to increased mobility of capital, as countries compete to lower the cost of capital within their jurisdictions, is not borne out by the data to date (Devereux, et al., 2004). Among other things this may reflect the fact that capital is not, in reality, completely mobile and the fact that tax competition impacts countries differently (Troeger, 2013).

5.2.4 Location and Reporting of Economic Activity for Tax Purposes

101. A number of studies have sought to assess the extent of base erosion and profit shifting activities by comparing the location of 'actual business activities' and where profits are reported for tax purposes (OECD, 2013, p. Annex B).

102. An econometric analysis using value added data from 16 OECD countries found evidence suggesting that a substantial share of revenues from a unilateral increase in the corporate tax rate by a country is lost because of a decline in reported income due to profit shifting (Bartelsman & Beetsma, 2003).

103. Studies using data from taxpayer returns have found evidence that profits had been shifted to low-tax jurisdictions, particularly as a result of the difficulties in pricing intellectual property (McDonald, 2008). Similarly, a meta-analysis of 23 studies on profit shifting behaviour by multinational enterprises found indirect evidence of profit shifting to low-tax jurisdictions, attributing this primarily to (non-arm's length) transfer pricing and licencing (Heckemeyer & Overesch, 2012).

104. The OECD observes that these studies generally conclude that profits, particularly those derived from 'mobile activities' are shifted for tax purposes to where they benefit from more favourable tax treatment, and that this gap has risen over time. Nevertheless, the OECD concludes that these studies are no more than 'circumstantial evidence of the existence of base erosion and profit shifting', due to the difficulty in ensuring the completeness and comparability of data (OECD, 2013).

5.3 Trends in Sources of Risk

105. Another way of assessing how the risks to Australia's corporate tax base may have changed (and may be changing) over time is to analyse trends in the underlying sources of risks identified in the previous Chapter.

106. These risks arise from entrenched structural features of the corporate tax system, including tax treaties; globalisation and tax competition; and changes in the global economy, including the rise of the digital economy and the global reach of multinationals.

107. There is a consistent view in the academic literature and official studies that these risks have been rising.

108. In a recent article commenting on the Mirrlees review of taxation conducted in the UK, Alan Auerbach identifies three issues for the US. First, the growth in importance of multinational enterprises (which now account for around 25 per cent of world GDP) has made the treatment of international capital flows a key issue of first-order importance. Second, financial innovation has increased the ability of corporations to exploit differences in the tax treatment of debt and equity. Finally, the corporate-noncorporate boundary has shifted, with a much greater share of business activity and income escaping the traditional corporate form and the corporate income tax (Auerbach, 2012, p. 15).

109. The global reach of multinational enterprises is also evident in strategies that seek to exploit gaps and inconsistencies in tax treaties between countries. Such schemes have seen the rise of 'stateless income', which is argued to pose an increasing challenge to the tax sovereignty of national governments (Kleinbard, 2011), or situations where tax treaties delegate residency to the domestic rules of the countries, enabling multinational enterprises to create 'stateless entities'.[19]

[19] US Senate Permanent Subcommittee on Investigations on Offshore Profit Shifting and the US Tax Code.

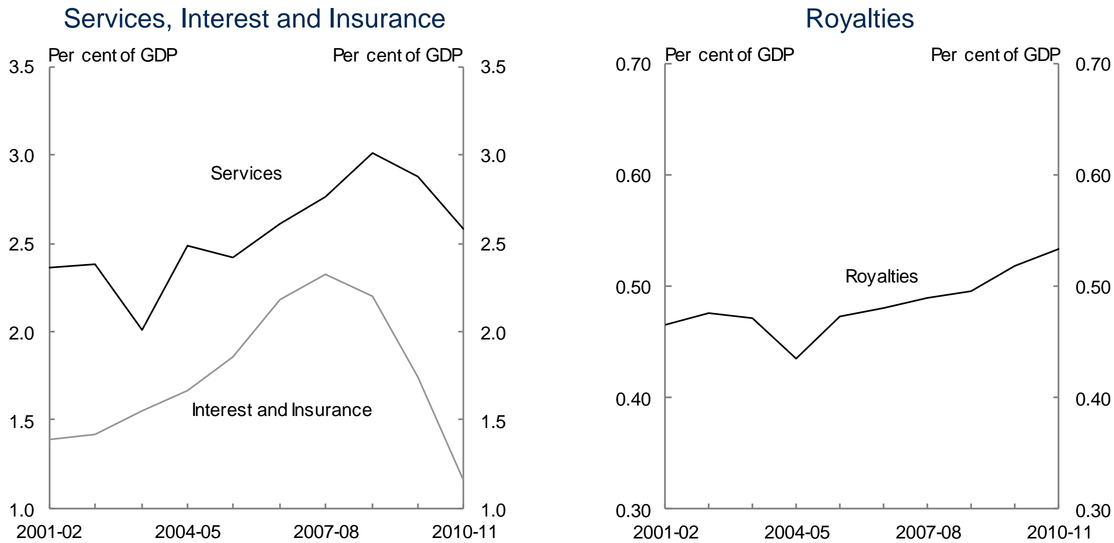
110. Our treaties are an important feature of our international tax architecture and provide significant benefits to Australia, however, the risks associated with the treaty network are growing and we need to be aware of the factors driving those risks. Some tax planning structures utilise the sequencing of transactions through jurisdictions to take advantage of treaty provisions or avoid treaty limitations. Tax planning, like many other innovative products or services, is able to be diffused and replicated readily.

111. The size of the treaty network is also a risk. The global treaty network, rather than simply the Australian network, present opportunities for structures that can shift profits out of Australia. The size of the treaty network presents challenges around ensuring our own treaties continue to serve the national interest but also in relation to limitations on our ability to influence the bilateral treaties of other countries. Finally the rapid adoption of technology by business does not sit well with the slow pace at which countries, and the international community more broadly, change their treaty practice.

112. A key concern is that tax planning techniques developed as a result of these strategies are becoming more prevalent over time. That is, there is a product life cycle of tax planning techniques, whereby the longer they are able to be used without being challenged the more they will be seen as acceptable and used more broadly through the community. Moreover, 'in competitive markets whatever is possible becomes necessary' (Shaxson, 2012, p. 130). This could help to explain the OECD's conclusion that 'a number of indicators show that the tax practices of some multinational companies have become more aggressive over time' (OECD, 2013, p. 6).

113. The Issues Paper documented the growing integration of production in global supply chains and the increasing share of value added in advanced economies being derived from intangible assets. While these are clearly developments for global prosperity generally, they also pose significant challenges to the tax systems of individual countries, with a number of studies pointing to a rising level of 'mobile rents'. Cross border intra-firm dealings reported by taxpayers in Australia have shown a strong upward trend over the past decade, although this was affected by the onset of the Global Financial Crisis, particularly in relation to related party interest and insurance payments (see Chart 7).

Chart 7: Intra-firm dealings



114. Similarly, while the continued growth in the scale and scope of the digital economy is overwhelmingly positive for community welfare, in the absence of an updated international tax framework this growth poses significant risks to the corporate tax bases of countries. The implications for the tax system as a growing number of industries 'digitise', particularly those providing services to business, are not well understood but potentially significant as they affect, either directly or indirectly, all sectors of the economy.

115. While OECD countries have committed to action to address harmful tax practices, the effectiveness of these measures has been constrained by the use of a very limited definition of a harmful tax practice. Among other things, to be harmful a measure is required to provide preferential treatment (such as a lower tax rate than would generally apply in a country) and be subject to ring-fencing to protect the domestic tax base (such as being limited to non-residents or offshore activity). However, this definition does not address situations where a country explicitly decides to adopt a harmful tax regime, where it gives up some of its corporate tax base in order to attract 'mobile rents' from other countries.

6. Addressing Risks to Australia's Corporate Tax Base

116. As discussed in Chapter 4, risks to Australia's corporate tax base have both fiscal and broader economic impacts. In addition, erosion of corporate tax bases globally implies the scope for action is beyond any single country acting independently. It is therefore important that Australia's interests are prosecuted through multilateral forums.

117. The Issues Paper noted that a number of different perspectives on both the extent of problems with current tax rules and the most appropriate solutions, and the nature of the issues involved, mean that policy approaches are likely to be pursued at a range of different levels and over different time periods. This includes improving compliance with existing rules, unilateral and multilateral policy responses, and measures to improve the monitoring of risks.

118. Many submissions noted that as Australia already had among the most robust corporate tax rules and compliance arrangements of the OECD, the focus of Australia's policy response to the risk of corporate tax base erosion should be in shaping and leading efforts to improve multilateral reform efforts.[20]

119. The section concludes with an analysis of the proposed OECD-G20 Action Plan to address base erosion and profit shifting.

6.1 Importance of Risks to Corporate Tax Base

6.1.1 Fiscal Implications

120. Australia's company income tax revenue as a proportion of GDP at 4.25 per cent is higher than the OECD average of just over 3 per cent. This is attributable to Australia's comparatively high levels of corporate sector profits, particularly from the resource sector, and effective enforcement, rather than reflecting the level of Australia's corporate tax rate, which is generally in line with OECD economies.

121. This greater reliance on corporate tax means that Australia is more vulnerable to corporate tax base erosion than other OECD countries. As such, it is important that policy and administration are vigilant in addressing risks as they are identified. This was generally acknowledged in submissions on the Issues Paper:

> Australia is right to remain vigilant and encourage a comprehensive co-ordinated approach by jurisdictions to target tax avoidance and evasion

[20] See, for instance, submissions to the Issues Paper by PriceWaterhouseCoopers, Ernst &Young, and TD Bank, 2013, *Submission to Issues Paper — Implications for the Modern Global Economy for the Taxation of Multinational Enterprises*, May 2013.

through profit shifting and ensure Australia's tax laws are adequate to deal with profit shifting.[21]

6.1.2 Economic Implications

122. Australia's relatively high level of corporate tax collections also means that base erosion and profit shifting could have significant adverse consequences for the broader economy and individual welfare. Falling company tax receipts would require an additional share of the taxation burden to fall on other taxpayers, which may not align with Government objectives.

123. In addition, base erosion and profit shifting could undermine economic efficiency, as some businesses, such as those which operate cross-border and have access to sophisticated tax expertise, may have greater access to these opportunities, providing them with a competitive advantage compared with enterprises that operate mostly at the domestic level. This would have distortionary effects on the allocative efficiency of the economy.

6.1.3 Tax System Confidence

124. An increasing awareness of tax avoidance being undertaken by some taxpayers also has the potential to erode broader confidence in the tax system. If taxpayers (including individuals) think that multinational corporations can structure their affairs to take advantage of differences in countries' tax laws it could undermine voluntary compliance by all taxpayers — upon which modern tax administration depends.

125. Examples of such practices, and accompanying costs, have found their way into public discourse in recent times due to several prominent cases where tax planning has yielded low effective rates of taxation on group income over recent years.[22]

126. The importance of community confidence in the tax system was noted by a number of submissions to the issues paper. In this context it was noted that it was important for this debate to be measured, balanced, and well informed.

6.1.4 Impact on Developing Countries

127. Australia has a clear national interest in and seeks to support the development of other countries.

128. A number of submissions to the Issues Paper highlighted the importance of a strong and sustainable tax base in fostering the independent economic and institutional growth of a country, allowing developing countries to move away from an over-reliance on foreign aid. These submissions argued that Australia's broader national interest was served by supporting approaches to base erosion and profit shifting that improved the ability of developing countries to address these challenges. In particular, the Tax Justice Network argued that:

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[21] The Minerals Council of Australia, 2013, Submission to Issues Paper – *Implications for the Modern Global Economy for the Taxation of Multinational Enterprises*, May 2013.

[22] See US Homeland Security and Governmental Affairs Permanent Subcommittee on Investigations 20 May 2013.

> Australia's aid program includes the objectives of 'improving incomes, employment and enterprise opportunities for poor people' and 'improving governance in developing countries to deliver services, improve security, and enhance justice and human rights for poor people. To have any hope of fulfilling these aims it is necessary to ensure developing country governments are able to generate enough sustainable revenue for themselves.[23]

129. The nature of these challenges were highlighted in the OECD's report released earlier this year:

> Developing countries often have no rules or ineffective rules for dealing with BEPS issues and lack the capacity to draft effective rules. They also face significant challenges in obtaining the relevant data and information to enable them to effectively implement their rules. The other major challenge facing developing countries is building the capacity to effectively implement rules based on international standards.
>
> (OECD, 2013, p. 87)

6.2 Policy Approaches to Corporate Tax Base Erosion

6.2.1. Improved Compliance with Existing Rules

130. The February 2013 OECD report recognised that improving compliance with the existing tax laws of countries, including through more effective enforcement action by tax authorities, had an important part to play in addressing base erosion and profit shifting.

131. Increasingly revenue authorities are realising the benefits of cooperation in developing a more complete understanding of the value chains of multinational enterprises, with this being a central theme of the recent OECD Forum of Tax Administration in Moscow on 16-17 May. The communiqué from the Forum noted that:

> We will rapidly increase the use of the provisions of the greatly expanded network of agreements allowing for exchange of information, including by providing necessary training to tax auditors, and we will ensure effective and secure use of information received under those agreements.[24]

132. Submissions on the Issues Paper noted that the ATO is an effective tax administration that has a strong reputation internationally. The 2013-14 Budget also provided the ATO with additional funding to increase its focus on areas with a high risk of base erosion and profit shifting including areas like offshore marketing hubs and business restructures.

133. Australia also undertakes considerable capacity building work in the region. An important element in improving collaboration between revenue authorities is to build

[23] Tax Justice Network, *Submission to the Issues Paper on Implications of the Model Global Economy for the Taxation of Multinational Enterprises*, 31 May 2013.

[24] Forum of Tax administration final communiqué, Moscow P. 1. *Site: http://www.oecd.org/ctp/administration/FTA-2013-Communique.pdf.*

the capacity of emerging and developing countries by sharing expertise and knowledge. Capacity building can offer enhanced outcomes for governments seeking to enforce their taxing rights both under existing arrangements and future changes. Consistent with this approach the OECD has launched a feasibility study into an initiative *Tax Inspectors Without Borders* that would seek to provide assistance to tax authorities, particularly in relation to complex audit activity.

6.2.2 Improved Tax Transparency

134. There is an increasing focus by some groups on the role that tax transparency can play in addressing base erosion and profit shifting issues. The Government recently enacted reforms to Australia's own tax confidentiality provisions to enable the public disclosure of certain tax information by large corporate entities.

135. A number of submissions on the Issues Paper also stressed the importance of increased transparency to addressing base erosion and profit shifting, both in Australia and particularly in developing countries. Other submissions were more cautious, noting that increased transparency could have costs as well as benefits.

136. A key reason for this diversity of views is that there are different perspectives on the policy objective of increased tax transparency, and a range of definitions of what it means in practice.

137. In general terms, there are two broad objectives of increased tax transparency: improving compliance with the current tax law and informing public policy debate on what those laws should be. In both cases, these objectives can be further refined in terms of whether the focus is on tax evasion (where a taxpayer wilfully ignores their obligations under the law) and tax avoidance and minimisation (where a taxpayer seeks to act within the law to avoid or minimise a tax liability). Further, public policy debate could be focused on a specific area of the tax law or broader questions of the sustainability of the tax system.

138. Similarly, the design of tax transparency tools revolves around two essential questions: what is the nature and level of information to be disclosed and to whom should it be disclosed? The information disclosed can range from disclosing the level of tax payable in a jurisdiction to providing detailed explanations of the nature and extent of complex transactions with significant potential taxation implications. Similarly, in some cases information exchange could be limited to tax authorities while in other situations public disclosure is envisaged.

139. A key policy question is how best to match the transparency tools with the policy objective in each circumstance.

140. There can be costs as well as benefits from tax transparency which in turn can affect the effectiveness of achieving its desired objective. For example, a traditional rationale for the confidentiality of taxpayers' information provided to tax authorities is that the frankness required for effective compliance with the tax law would be undermined if this information was made public. On the other hand, there is a strong argument that rules governing confidentiality of multinational tax affairs have inhibited the ability of national governments to put in place effective laws to address base erosion and profit shifting.

141. This highlights the importance of being clear on the objective of a tax transparency measure, and targeting the measure to best meet that objective.

6.2.3 Unilateral Policy Reforms

142. The Issues Paper noted that while countries should take immediate action to address integrity concerns in relation to the tax law, there was a risk that this would result in double taxation unless this was done consistently within the existing international framework.[25]

143. Submissions on the Issues Paper argued that Australia's corporate tax rules were among the more robust in the OECD, and that they had been further strengthened by recent reforms to transfer pricing and general anti-avoidance rules, along with several integrity measures announced in the 2013-14 Budget. In addition, the Government recently announced a Board of Taxation review of Australia's debt and equity rules that amongst other things will examine whether the system can be improved to address inconsistencies between Australia's and other jurisdictions' rules that could give rise to tax arbitrage opportunities.

144. Overall, this suggests that there are unlikely to be substantial additional policy reforms that Australia could enact unilaterally in the short term to address base erosion and profit shifting. Nevertheless, the pace of innovation in tax planning, even purely within a domestic setting, reinforces the need for governments to be able to respond where necessary to emerging risks.

145. This points to the need for a regular report to be prepared on the health of the business tax system generally, and the emergence of risks. This could include presentation of case studies of transactions and structures that present risks to the corporate tax base, along with a more detailed level of data on the business tax system than presented in the ATO's *Taxation Statistics* publication. Consistent with feedback from submissions, the report should fully utilise data before seeking additional information from taxpayers.

Recommendation 1

(a) The current public release of taxation statistics should be expanded to better cover international dealings of multinational enterprises.

(b) An annual report on the health of the business tax system should be published.

146. Another possible focus of attention is on re-examining areas where Australia has restricted its taxing rights. This could include formalising a periodic, systematic review of Australia's bilateral tax treaties to ensure they are still in the national interest. The majority of Australia's 44 treaties were signed (or last amended) prior to 2000, with 15 treaties dating back to the 1970s and 1980s. As a result, most of Australia's treaties predate current tax treaty policy settings and recent developments in international business practices.

[25] Actions and proposals of other countries are summarised in Appendix A.

Recommendation 2

Each of Australia's bilateral tax treaties should be reviewed at least once a decade, in order to ensure that they continue to be in the national interest.

147. Following the success of the Global Forum on Transparency and Exchange of Information for Tax Purposes, Australia has made substantial progress in building its network of exchange of information agreements. There is an international consensus that countries should implement measures to defend their tax bases from evasion involving jurisdictions that are unwilling to engage in effective exchange of information. The Global Forum is in the process of completing its evaluation of whether member countries are effectively exchanging information.

Recommendation 3

Australia should consider exploring options to further improve the way tax authorities work together including through expanded and more timely exchange of information for tax purposes.

6.2.4 Multilateral reforms

148. The February 2013 OECD report highlighted the need to update the international tax architecture to reflect changes in the global economy and the evolution of business practices. Achieving meaningful multilateral policy reform will be difficult, as countries have a range of interests and perspectives. On the other hand, in the absence of a credible plan to develop and implement multilateral reforms it is more likely that governments would undertake 'unilateral and uncoordinated actions' in isolation to protect (and expand) their corporate tax base, increasing the risk of double taxation, and damaging cross-border trade and investment.

149. In addition to policy reforms, reform of the global network of over 2000 bilateral tax treaties could also be considered. The current patchwork of bilateral treaties is arguably an important source for tax planning opportunities by multinational enterprises. As such, an institutional shift over time from bilateral to multilateral tax treaties could offer greater consistency between agreements, reducing tax planning opportunities and enabling the international tax architecture to be more responsive to developments in the economy and business practice.

6.3 OECD Action Plan: Proposed OECD-G20 BEPS Project

150. Last year the G20 called on the OECD to undertake a study of base erosion and profit shifting which resulted in the February 2013 report *Addressing Base Erosion and Profit Shifting* and the Action Plan.

151. The Action Plan sets out a work program for addressing the key drivers of base erosion and profit shifting. Importantly this plan includes a strategy for providing non-OECD members with an opportunity to participate on an equal footing with member countries. A summary of the Action Plan is contained in Appendix B.

Recommendation 4

Australia should endorse the Action Plan which establishes a joint OECD and G20 project with a comprehensive work program to address the key drivers of base erosion and profit shifting.

6.3.1 Digital Economy

152. The difficulty of applying tax concepts developed in an industrial age has been recognised for some time (ATO, 1997). However, previous attempts to address these challenges have focused on how to adjust existing tax concepts to suit the digital economy. In part, this reflected the relatively small size of the digital economy at the time. However, it also reflected a limitation of ambition in order to achieve required multilateral consensus. As one article in 1999 commented:

> Wide-ranging discussions of radical ideas such as the 'bit tax', and of the real meaning of the principles underlying international taxation have been discarded to enable us to focus on the serious business of implementing the agreed international agenda.
>
> (Bentley, 1999)

153. The very significant growth in the size and the scope of the digital economy over the past decade requires reconsideration of this approach. In addition to rapid growth in electronic commerce in goods and services to consumers, the digital economy is increasingly affecting the traditional business models in a wide range of industries. The current international rules allocating taxing rights have been criticised as resulting in income generated in the digital economy (and from intangible assets generally) being allocated for tax purposes to neither the country where the intellectual property was developed nor the market in which intellectual property protection is provided (or some combination thereof).

154. The OECD Action Plan recognises that a more holistic approach may be needed to address the tax challenges of the digital economy. It recognises that further analysis is needed for national governments to be in a position to consider specific reforms in this area. In particular, there is a need to better understand how the digital economy changes traditional views of the imposition and incidence of tax, and the pros and cons of different options to address these challenges. The OECD proposes that a taskforce would prepare a report on these issues by September 2014, which in turn would inform approaches on other elements of the Action Plan.

6.3.2 Hybrid Arrangements

155. Tax arbitrage opportunities in the form of hybrid mismatch arrangements can arise whenever economically equivalent entities, instruments or transfers are treated differently for tax purposes in two or more jurisdictions. The arrangements may lead to situations where there is double non-taxation or multiple uses of a particular loss or deduction amount; the arrangements in some circumstances exploit exemption rules as well as deferral rules which, when they allow for the long-term deferral of tax, effectively facilitate non-taxation.

156. Hybrid entities include arrangements, such as limited partnerships, that have elements of both a corporate and non-corporate entity. A key issue for tax purposes is that taxation might be applied at the entity level in one country and at the investor level in another. In addition to opening the potential for tax planning opportunities (such as where a deduction is allowed in both jurisdictions) this can result in double taxation.

157. Hybrid transfers (or synthetic transfers) are arrangements that result in the effective transfer of the risks and benefits associated with ownership of an asset without actually being a legal sale of the asset. This can present tax planning opportunities between (and within) jurisdictions, particularly where the transfer is recognised as a disposal or acquisition in one country and not another.

158. Hybrid instruments typically refer to instruments that have characteristics of both debt and equity (such as redeemable preference shares). Tax planning opportunities arise for multinational enterprises where these instruments are treated as debt in one jurisdiction (with interest then allowed as a deduction) and equity in another (where typically the dividend is not subject to tax).

159. The OECD Action Plan proposes action to neutralise the effects of hybrid mismatch arrangements. This could be achieved by changes to treaty practice through reforms to the OECD Model Tax Convention, as well as to domestic law provisions regarding certain types of exemptions and deductions. The OECD Action Plan specifically calls for addressing scenarios where exemption or non-recognition rules apply to the recipient of an amount when payments are deductible by the payor; where deductions are available for a payment that is not included in the assessable income of the recipient; and where deductions for the same amount are available in two jurisdictions. The OECD Action Plan also calls for coordination or tie-breaker rules when more than one country seeks to apply the rules to a particular transaction or structure; it also acknowledges the importance of coordinating the interaction between this action item and those on interest expense deductions, the Controlled Foreign Company (CFC) rules and treaty shopping.

6.3.3 Excessive Debt Deductions

160. The fundamental differences in the tax treatment of debt and equity can influence the capital structure of multinational enterprises. Multinational enterprises have more flexibility than domestic enterprises in determining where international financing can occur and how debt will be allocated within the group. This flexibility can enable interest expenses to be shifted across the group, resulting in profit shifting for tax purposes. Similar flexibility exists with other financial payments.

161. The OECD Action Plan proposes the development of best practice design guidelines in relation to rules to restrict excessive debt deductions, including where debt is used 'to finance the production of exempt or deferred income'. It will also develop further guidance on the pricing of related party financial transactions.

6.3.4 Transfer Pricing

162. Most developed economies have comprehensive 'transfer pricing' or cross-border 'profit allocation' rules. While the role of such rules is to protect the tax base from profit shifting, they perform other important roles for investors and trading partner

governments in clarifying the rules for cross-border profit allocation, and broad parity between the tax treatment of multinational enterprises and businesses that operate entirely domestically.

163. The relatively high degree of international consistency in transfer pricing rules has been overwhelmingly influenced by the work of the OECD. Transfer pricing rules typically use the principle of applying tax on the basis that related party arrangements had taken place between independent parties acting in their own commercial interests. Through this mechanism transfer pricing regimes seek to ensure that appropriate returns for the economic contribution made by operations in a particular jurisdiction are reflected in the tax base of that jurisdiction. The most difficult transfer pricing challenges have evolved from changes in the global business environment, driven by a range of factors including broader policy developments and technological advancement.

164. Transfer pricing frameworks analyse where assets are located, where functions take place and where risks are assumed and managed. Current transfer pricing frameworks generally work well for the type of trade that existed when they were first developed. However, the rapid development of technologies has raised opportunities to centralise functions and harness efficiencies that multinationals in the most traditional of industries can now adopt. With these efficiency benefits also come tax planning opportunities.

165. Such challenges arise where assets do not exist in any physical location or transit readily between jurisdictions, where activities or services can be effectively delivered from any location and where the mobility of assets and activities mean that the associated risk bearing and risk management is equally difficult to locate. These mobile and intangible factors of production are also among the most difficult to value.

166. The OECD Action Plan includes specific action items to improve transfer pricing rules for hard to value intangibles, measures to address profit shifting opportunities arising out of the way risks are allocated amongst a multilateral group and high risk transactions that independent parties would not normally enter into. Other action items (such as in relation to excessive debt deductions) also have transfer pricing aspects. These categories closely mirror the most significant challenges Australia faces in area of transfer pricing.

6.3.5 Preventing Treaty Abuse

167. The OECD Action Plan proposes the development of model treaty provisions to limit the potential for tax treaties to be exploited to generate outcomes where there is double non-taxation. This will include the development of best practice guidelines on domestic rules countries could adopt to prevent treaty abuse, and policy considerations for countries to consider before entering into a tax treaty with another country.

6.3.6 Artificial Avoidance of Permanent Establishment Status

168. The concept of 'permanent establishment' is used to determine taxing rights over business profits derived in one country by a resident of another country. The underlying principle is that the presence should not be merely transitory. Under a tax

treaty, the source country is permitted to tax business profits derived by a foreign resident to the extent that they are attributable to a permanent establishment located in the source country. However, both countries retain taxing rights over the income and assets of permanent establishments.

169. The permanent establishment rules date back to a time when the bulk of economic activity took place at a physical location. The rise of the digital economy, which essentially has no physical location, led to changes to the guidance material to: include examples of when electronic commerce (such as electronic equipment), facilities such as cables or pipelines or agents are treated as a permanent establishment; exclude activities that were preparatory or auxiliary; and include alternative provisions that countries can use to allocate profits from the provision of services.

170. Although these modifications have been made to adjust to the changing international environment, the changes have sought to 'shoehorn' the developments to fit within the pre-existing concepts. The net effect is that it is 'possible to be heavily involved in the economic life of another country … without having a taxable presence therein' (OECD, 2013, p. 7).

171. In some cases, countries can modify their tax treaties to overcome some of these issues. For example, Australia seeks to include anti-contract splitting rules in its treaties to prevent manipulation of the time period thresholds that apply to treat certain building and construction and natural resource activities as a permanent establishment. However, tax treaties cannot overcome the fundamental issues that arise from operating in a digital economy.

172. To ensure an appropriate share of tax revenues between jurisdictions is achieved in the changing environment and to prevent the artificial avoidance of permanent establishment status, the rules need to be modified. One option is to explore whether a better balance can be achieved by changing the rules so they rely on the level of economic activity rather than on a physical presence.

173. The OECD Action Plan proposes to prevent the artificial avoidance of permanent establishment status, in particular through the use of 'Commissionaire arrangements' and other structures that exploit activities that are excluded from the permanent establishment definition. Essentially, under the permanent establishment definition, activities carried on through dependent agents are treated as permanent establishments whereas activities carried on through independent agents acting in the ordinary course of their business are not treated as permanent establishments. Commissionaire arrangements involve the interposition of agents (commissionaires) between sellers and purchasers of goods or services to exploit these rules and effectively negate the existence of a permanent establishment.

6.3.7 Strengthening CFC Rules

174. CFC rules seek to protect against the use of related entities based in low or no tax jurisdictions to avoid tax by deeming certain types of income (including 'passive'

income and income from some related party transactions) to be assessable in the parent company's jurisdiction typically on an accruals basis.[26]

175. The February 2013 OECD report notes that in practice the CFC rules in many countries have not been as effective as intended, with examples of multinational enterprises being able to structure arrangements to inappropriately fall outside the scope of the rules. On the other hand, CFC rules have also been criticised as imposing disproportionately high compliance costs on business.

176. The OECD Action Plan will develop recommendations to strengthen the design of CFC rules.

6.3.8 Harmful Tax Competition

177. The Forum on Harmful Tax Practices (the Forum) provides a framework that countries can use to identify and eliminate harmful tax regimes so as to create an environment in which free and fair tax competition can take place.

178. The Forum has succeeded in eliminating a number of harmful tax practices. However, this has taken a considerable period of time, reflecting the consensus approach of the OECD. Moreover, the Forum does not appear to have significantly limited the ability of multinational enterprises to shift income from 'mobile rents'. As such, it is questionable whether the criteria and processes used to determine whether a regime is harmful are adequate. For example, under the current definition of 'harmful tax practice', a regime that is considered potentially harmful may not have to be abolished or modified if the jurisdiction has in place effective arrangements for the exchange of information.

179. Unlike the process used for the Global Forum on Transparency and Exchange of Information for Tax Purposes that has decisions reviewed by a peer review process, currently there are no procedures in place to review decisions made by the Forum. The Forum conducts a preliminary scan of member country regimes based on publicly available information. Relevant countries then undertake a self-assessment of the regimes identified by the Forum and provide advice to the Forum as to why or why not the regime might be considered harmful, with reference to the OECD's guidelines. Based on this work, together with referrals and self-reviews of regimes provided by delegates, the Forum then decides whether a regime is considered harmful.

180. The OECD Action Plan proposes a revamp of work on harmful tax practices, with a more holistic approach to evaluating regimes in the context of general concern about base erosion and profit shifting. It will focus on improving transparency and requiring substantial (real economic) activity in order for a preferential regime to not be regarded as harmful.

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[26] That is, it is an example of the application of a worldwide approach to taxation that is often combined as an anti-avoidance measure.

6.3.9 Data Methodology

181. The February 2013 OECD Report noted that a key challenge in assessing the level and growth of base erosion and profit shifting was the lack of agreed standards on the collection of data and appropriate metrics to use as a benchmark.

182. The Action Plan will establish methodologies to collect and analyse data on base erosion and profit shifting, including recommendations on the development of indicators to monitor the scale and economic impact of base erosion and profit shifting over time.

6.3.10 More Effective and Efficient Compliance

183. The Action Plan also includes several items aimed at supporting more effective and efficient compliance, including increased disclosure of 'aggressive tax planning arrangements', improving transfer pricing documentation to be more useful for tax authorities and less onerous on business, and improving the effectiveness of resolution of tax disputes between countries, particularly in relation to disputes over tax treaties.

7. Australia's International Engagement

184. The underlying drivers of corporate tax base erosion are international in nature, and beyond the scope of any one country, acting alone, to resolve. Addressing the threat posed to the corporate tax bases of countries from base erosion and profit shifting will inevitably require effective multilateral action.

185. An effective strategy of international engagement on BEPS will be critical to achieving an improved international tax framework and avoiding outcomes that are inconsistent with Australia's national interest. In this context, a critical issue for Australia to consider is how to engage internationally in order to encourage and build momentum for effective multilateral action.

186. This includes what forums we seek to progress this work through, how much and how we engage in order to have the greatest impact, and how international action is structured and monitored to keep up momentum over the medium to longer term.

7.1 Multilateral Tax Reform

187. The successful implementation of major tax reform within a country requires the disparate and at times conflicting interests of different groups within the community to be managed. In particular, the implementation and durability of reforms can be critically affected by how national governments engage with those made worse off as a result — even where the reforms are generally agreed to result in national net benefits (Brys, 2010).

188. These challenges are even greater when dealing with multilateral reforms, as the costs and benefits of reform are unevenly distributed between, as well as within, countries (De Serres, et al., 2011).

189. In the context of multilateral tax reforms, different countries will have different interests. The perspective of a large, capital exporting developed economy will differ from that of a small capital importing emerging economy. In practice, however, classification of a country's national interest is rarely this straight forward, as it reflects the net result of a range of interests. For example, Australia is an example of a country that is a net capital importer that also exports a significant amount of capital. Moreover, as countries develop their interests can change significantly over time.

190. This highlights the difficulty in achieving significant multilateral reform on an issue as central to national sovereignty as taxation. That said, the progress made in recent years by the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes (Global Forum) demonstrates that achieving multilateral reform is indeed possible. While efforts to improve international co-operation and information sharing on tax matters had been in place for some time prior to the global financial crisis, progress had been relatively modest. The political support of G20 Leaders in the aftermath of the global financial crisis, including the threat of sanctions, crystallised the implementation of previous commitments, and ensured all major offshore financial centres were members of the Global Forum. While the process is

far from complete, this has started to change international practice, as member countries and jurisdictions respond to the recommendations of peer review reports and more than 800 agreements that provide for the exchange of information in tax matters have been signed by various jurisdictions.

191. It is also important to note that the alternative to multilateral tax reform is not necessarily the maintenance of the status quo. As the OECD has highlighted, in the absence of a credible plan for multilateral reform, it is likely that at least some countries will take unilateral action to protect (or expand) their tax bases, potentially resulting in double taxation and/or increased disputes between national governments, adversely affecting cross-border trade and investment.

7.2 Australia's Ability to Influence as a Middle Power

192. Like other countries, Australia's approach to multilateral reform initiatives is ultimately grounded in its national interest. However, Australia has long recognised the limits of its ability to protect its interests by asserting its power based on economic weight.

193. As a middle power, Australia has the opportunity to have its views listened to in international forums. Australia is traditionally most influential in multilateral forums when it presents views within a principled framework, advocating rules-based approaches. This reflects a view that Australia's interests are usually best served by using its influence to advance initiatives that result in a net global benefit.

194. In practice, this means that Australia has an active interest in the effective functioning of multilateral institutions. The mix and nature of Australia's relationships means that we are well placed to provide technical and political leadership on multilateral tax reform. Australia is a modern, sophisticated knowledge economy with a high level of commodity exports that is both a significant importer and exporter of foreign direct investment and one of the largest fund management sectors in the world.

7.3 Role of Different Forums on Multilateral Tax Reform

195. A key issue for progressing multilateral tax reform is the role that different international forums, such as the OECD and G20, can play that best reflects their relative strengths.

196. The OECD is widely acknowledged as the pre-eminent multilateral institution on tax technical matters. As an organisation that operates on a consensus basis, with well-established links for consulting with business, the tax profession and civil society, it has a track record of achieving outcomes with broad agreement. However, seeking consensus can take a long period to be concluded and can limit the scope and ambition of reform.

197. The OECD Action Plan proposes a joint OECD/G20 project on Base Erosion and Profit Shifting. The OECD's acknowledged technical expertise makes it the logical forum for the development and implementation of technical improvements to the international tax framework. The G20 brings together senior decision makers from a

broadly representative group of countries, giving it an important role to play in ensuring broad political ownership of the technical work of the OECD.

198. Under this approach, non-OECD G20 countries would participate in all discussions within the OECD on Action Items on an equal footing. In addition, non-OECD G20 countries will be represented on the 'CFA Bureau Plus',[27] the group that will oversee the overall base erosion and profit shifting project.

7.4 Australia's Engagement in OECD/G20 BEPS project

199. As G20 chair in 2014, Australia can play a prominent role in determining and driving the base erosion and profit shifting reform agenda.

200. As a member of the OECD, Australia is represented in all of the OECD working groups and committees involved in progressing the OECD/G20 BEPS project. This representation is usually through Australian government officials (usually from the Treasury, ATO or Department of Foreign Affairs and Trade).

201. Australian officials involved in the BEPS project will also consult with stakeholders throughout the project. In addition, both the OECD and G20 have established liaison groups to bring business, academic and civil society contributions into policy considerations.

202. Australia can also encourage and enable countries in the region to actively participate in these discussions, including through capacity building initiatives.

7.5 Effective Timeframes for Action

203. The political imperative for action to address base erosion and profit shifting, along with the history of very long timeframes for multilateral tax reform efforts, has resulted in the OECD Action Plan having a focus on concrete actions to be delivered by clear deadlines.

204. The timeframe for achieving these outcomes is ambitious, with the Action Items scheduled to be completed by the end of 2015. Taking action quickly to improve the integrity of international and national tax systems would send a clear signal to the community that concerns were being addressed. Too long a delay in taking action runs the risk that momentum for multilateral action will stall and individual countries will feel the need to take action unilaterally that would risk imposing double taxation and adversely affect cross-border trade and investment.

205. On the other hand, a concern with this ambitious timeframe is that it could result in the scope of action items being reduced in order to meet a deadline that is artificially tight. That is, excessive time pressure could detract from results. That is particularly the case for the proposed taskforce on the tax challenges of the digital economy which will require consideration of fundamental design features of the tax architecture, which would require a longer timeframe. Those parts of the OECD

[27] That is, the standard CFA Bureau plus the chairs of all the Working Parties.

Action Plan primarily focused on reforms within the existing international tax architecture should raise less timing issues.

8. Conclusions and recommendations

206. The mechanisms that have helped shape Australia's corporate tax system were developed in the context of a less integrated global economy than we have today. There is growing international concern that many of these key rules, developed many decades ago, have failed to keep pace with changing global business practices.

207. Reflecting many of the submissions to the Issues Paper, this Scoping Paper concludes that the extent to which base erosion and profit shifting is currently affecting Australia's corporate tax base is unclear. This reinforces the need to identify and make better use of information currently available to more clearly analyse these issues.

208. However, it is clear that there are real and identifiable risks facing Australia's corporate tax base and the corporate tax bases of other countries. The increasing use of strategies to exploit gaps and inconsistencies in tax treaties, the increased 'digitisation' of the economy and the challenges for the international community to effectively curb the harmful tax practices of some jurisdictions, have all highlighted shortcomings in the international tax framework.

209. There are some actions Australia can and has taken unilaterally; these are primarily focused on improvements that can be made without significant divergence from international tax settings.

210. But the key focus of Australia's efforts should be working multilaterally through international organisations to modernise international tax rules.

211. Given this, this paper makes the following recommendations:

Recommendation 1

(a) The current public release of taxation statistics should be expanded to better cover international dealings of multinational enterprises.

(b) An annual report on the health of the business tax system should be published.

Recommendation 2

Each of Australia's bilateral tax treaties should be reviewed at least once a decade, in order to ensure that they continue to be in the national interest.

Recommendation 3

Australia should consider exploring options to further improve the way tax authorities work together including through expanded and more timely exchange of information for tax purposes.

Recommendation 4

Australia should endorse the Action Plan which establishes a joint OECD and G20 project with a comprehensive work program to address the key drivers of base erosion and profit shifting.

Appendix A: Summary of International Reports

UK — UK House of Commons Report

212. The UK House of Commons Committee of Public Accounts has made a number of recent inquiries on aspects of the taxation of multinational enterprises. In November 2012, the Committee's 19th Report examined the issue of tax avoidance by multinational enterprises in the context of reviewing the annual report of Her Majesty's Revenue and Customs (HMRC). The Committee concluded that 'international companies are able to exploit national and international tax structures to minimise corporation tax on the economic activity they conduct in the UK' (House of Commons Committee of Public Accounts, 2013, p. 3). The Committee was also critical of what it described as 'a complete lack of transparency' about the amount of tax paid by multinational enterprises (ibid).

213. Among other things, the Committee recommended that HMRC and Her Majesty's Treasury develop best practice standards in relation to the information companies should release publicly about their tax practices and lead international efforts to reform tax rules that allow tax avoidance through profit shifting (House of Commons Committee of Public Accounts, 2013, p. 5).

US — US Congressional Budget Office report, 'Options for Taxing US Multinational Corporations' January 2013.

214. This report examines policy options for the US to move closer to either a worldwide or territorial approach to taxation (Congressional Budget Office, 2013). It also explores several approaches to addressing particular concerns about the current system of taxation. All approaches would affect the investment strategies of multinational corporations and reporting of income as well as US revenues from corporate income taxes.

215. It provides an overview of the worldwide and territorial approaches, before explaining and detailing the current tax treatment of US multinational corporations and some of the weaknesses of the current system. Profit shifting opportunities are discussed before reporting on estimates of the cost of profit shifting.

216. Amongst other things the report discusses the merits of removing the 'check the box system' and modifying the deferral rules.

France — Taxation of the Digital Economy (the Colin & Collin report)

217. The French Government commissioned a report on the taxation of the digital economy by Pierre Collin (a member of the French Conseil d'Etat) and Nicholas Colin.[28] The final report concluded that as a result of the way digital economy businesses 'regularly and systematically' collect, monitor and exploit users online activities, the boundary between production and consumption had been blurred.

218. The report makes the case for the international recognition of the concept of 'permanent virtual establishments' to reflect the view that a proportion of profits made by businesses in the digital economy derives from people in a country sharing their personal information. The report also puts an argument for France to unilaterally impose a tax on the collection of data. The report suggests that data is the only tax base that ensures neutrality across the digital economy.

New Zealand — Tax Policy report: Taxation of multinational companies

219. New Zealand's Inland Revenue report explains concerns about the amount of tax paid by multinational enterprises and how New Zealand and other countries are responding (New Zealand Inland Revenue, 2013). It also provides a brief summary of New Zealand's existing rules for ensuring multinational enterprises are taxed on activities that they perform in New Zealand.

220. Reference is made to activities Australia is undertaking such as the scoping paper, transfer pricing and Part IVA revisions. Recommendations are made to continue supporting the work of the OECD and for New Zealand to coordinate with Australia, noting both countries have similar approaches to international tax policy design and tax treaties. The paper discusses ineffective CFC rules and the ability to arbitrage between domestic laws, mentioning cross border arbitrage using hybrid instruments between Australia and New Zealand.

EU — European Commission report: An Action Plan to strengthen the fight against tax fraud and tax evasion

221. In December 2012 the European Commission released a communication to the European Parliament and Council entitled 'An Action Plan to strengthen the fight against tax fraud and tax evasion'. The action plan contains actions which EU Member States consider are needed to strengthen tax collection. The action plan seeks to increase administrative cooperation, close a number of value added tax and tax saving loopholes and implement an anti-fraud and tax cooperation agreement that will utilise transparency and exchange of information mechanisms to combat tax evasions.

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[28] The full report (in French) is available at: http://www.redressement-productif.gouv.fr/files/rapport-fiscalite-du-numerique_2013.pdf. An (English) summary of the report by one of the authors is available at: http://www.forbes.com/sites/singularity/2013/01/28/corporate-tax-2-0-why-france-and-the-world-need-a-new-tax-system-for-the-digital-age/.

US — United States Senate Permanent Subcommittee on Investigations (SPI)

222. On 20 September 2012, the SPI convened a hearing on 'Offshore profit-shifting and the US Tax code.' Participants included academics and officials as well as corporate executives (Microsoft and Hewlett Packard) and a consulting firm (Enrst & Young)—from whom documents were subpoenaed.

223. The SPI made a number of findings including that there are some current weaknesses in the current tax code's transfer pricing regulations and ambiguity in certain accounting standards. Check-the-box and 'look-through' rules were also found to have undermined the intent of the United States CFC rules.

UK — United Kingdom House of Commons Committee of Public Accounts (CPA)

224. On 12 November 2012 the CPA convened a hearing on tax avoidance by multinationals to provide a greater understanding of possible corporate tax avoidance. Starbucks, Amazon and Google were invited to appear as witnesses. The key finding was that the UK profit shifting rules and their administration are currently inadequate to grapple with the tax planning strategies undertaken by multinationals.

225. In the 2011-2012 financial year there was a decrease in corporate tax of £6.3 billion (despite an increase in total revenue). The report also stated that multinationals appear to be profit shifting by using transfer pricing, royalty payments for intellectual property and/or franchise payments to other group companies. The Committee was roundly critical of the multinationals and described the evidence as 'unconvincing and in some cases evasive'. The Committee report was also heavily critical of the Her Majesty's Revenue & Customs.

226. On 31 January 2013 the Public Accounts Committee in the United Kingdom convened its second hearing on tax avoidance, hearing evidence from the Big Four consulting firms. The four firms agreed that international taxation rules were out of date and need to change to reflect the reality of modern business. The committee heard useful examples of ways of better matching taxation with economic activity, as used in some US states. Simplicity was identified as key to fighting tax avoidance as the four firms agreed with the committee that the existing tax law was too complex. This extended to greater transparency over companies' tax affairs, which could increase the pressure on multinationals to pay a fair share of tax in the countries where they operate.

Appendix B: OECD Action Plan

ACTION	DESCRIPTION	DEADLINE
1. Address the Tax Challenges of the Digital Economy	Identify the main difficulties that the digital economy poses for the application of existing international tax rules and develop detailed options to address these difficulties, taking a holistic approach and considering both direct and indirect taxation. Issues to be examined include, but are not limited to, the ability of a company to have a significant digital presence in the economy of another country without being liable to taxation due to the lack of nexus under current international rules, the attribution of value created from the generation of marketable location-relevant data through the use of digital products and services, the characterisation of income derived from new business models, the application of related source rules, and how to ensure the effective collection of VAT/GST with respect to the cross-border supply of digital goods and services. Such work will require a thorough analysis of the various business models in this sector.	September 2014
2. Neutralise the Effects of Hybrid Mismatch Arrangements	Develop model treaty provisions and recommendations regarding the design of domestic rules to neutralise the effect (for example, double non-taxation, double deduction, long-term deferral) of hybrid instruments and entities. This may include: (i) changes to the OECD Model to ensure that hybrid instruments and entities (as well as dual resident entities) are not used to obtain the benefits of treaties unduly; (ii) domestic law provisions that prevent exemption or non-recognition for payments that are deductible by the payor; (iii) domestic law provisions that deny a deduction for a payment that is not includible in income by the recipient (or subject to taxation under CFC or similar rules); (iv) domestic law provisions that deny a deduction for a payment that is also deductible in another jurisdiction; and (v) where necessary, guidance on coordination or tie-breaker rules if more than one country seeks to apply such rules to a transaction or structure. Special attention should be given to the interaction between possible changes to domestic law and the provisions of the OECD Model Tax Convention. This work will be coordinated with the work on interest expense deduction limitations, the work on CFC rules, and the work on treaty shopping.	September 2014
3. Strengthen CFC Rules	Develop recommendations regarding the design of controlled foreign corporation rules. This work will be coordinated with other work as necessary.	September 2015

ACTION	DESCRIPTION	DEADLINE
4. Limit Base Erosion via Interest Deductions and Other Financial Payments	Develop recommendations regarding best practices in the design of rules to prevent base erosion through the use of interest expense, for example through the use of related-party and third-party debt to achieve excessive interest deductions or to finance the production of exempt or deferred income. The work will evaluate the effectiveness of different types of limitations. In connection with and in support of the foregoing work, transfer pricing guidance will also be developed regarding the pricing of related party financial transactions, including financial and performance guarantees, derivatives (including internal derivatives used in intra-bank dealings), and captive and other insurance arrangements. The work will be coordinated with the work on hybrids and CFC rules.	December 2015
5. Counter Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance	Revamp the work on harmful tax practices with a priority on improving transparency, including compulsory spontaneous exchange on rulings related to preferential regimes, and on requiring substantial activity for any preferential regime. It will take a holistic approach to evaluate preferential tax regimes in the BEPS context. It will engage with non-OECD members on the basis of the existing framework and consider revisions or additions to the existing framework.	December 2015
6. Prevent Treaty Abuse	Develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances. Work will also be done to clarify that tax treaties are not intended to be used to generate double non-taxation and to identify the tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country. The work will be coordinated with the work on hybrids.	September 2014
7. Prevent the artificial avoidance of PE status	Develop changes to the definition of PE to prevent the artificial avoidance of PE status in relation to BEPS, including through the use of commissionaire arrangements and the specific activity exemptions. Work on these issues will also address related profit attribution issues.	September 2015
8. Assure that Transfer Pricing Outcomes are in Line With Value Creation/ Intangibles	Develop rules to prevent profit shifting by moving intangibles among group members. This will involve: (i) adopting a broad and clearly delineated definition of intangibles; (ii) ensuring that profits are appropriately allocated in accordance with (rather than divorced from) value creation; (iii) developing special rules for transfers of hard-to-value intangibles; and (iv) updating the guidance on cost contribution arrangements.	September 2015

ACTION	DESCRIPTION	DEADLINE
9. Assure that Transfer Pricing Outcomes are in Line With Value Creation/ Risks and Capital	Develop rules to prevent profit shifting by transferring risks among, or allocating excessive capital to, group members. This will involve adopting transfer pricing rules or special measures to ensure that inappropriate returns will not accrue to an entity solely because it has contractually assumed risks or has provided capital. The rules to be developed will also require alignment of returns with value creation. This work will be coordinated with the work on interest expense deductions and other financial payments.	September 2015
10. Assure that Transfer Pricing Outcomes are in Line With Value Creation/ Other High-risk transactions	Develop rules to prevent profit shifting by engaging in transactions which would not, or would only very rarely, occur between third parties. This will involve adopting transfer pricing rules or special measures to: (i) clarify the circumstances in which transactions can be recharacterised; (ii) clarify the application of transfer pricing methods, in particular profit splits, in the context of global value chains; and (iii) provide protection against common types of base eroding payments, such as management fees and head office expenses.	September 2015
11. Establish methodologies to collect and analyse data on BEPS and the Actions to Address It	Develop recommendations regarding indicators of the scale of BEPS and ensure that tools are available to monitor and evaluate the actions taken to address BEPS on an ongoing basis. This will involve assessing a range of existing data sources, identifying new types of data that should be collected, and developing methodologies based on both aggregate (for example FDI and balance of payments data) and micro-level data (for example from financial statements and tax returns), taking into consideration the administrative costs for tax administrations and businesses.	September 2015
12. Require taxpayers to disclose their aggressive tax planning arrangements	Develop recommendations regarding the design of mandatory disclosure rules for aggressive or abusive transactions, arrangements, or structures, taking into consideration the administrative costs for tax administrations and businesses and drawing on experiences of the increasing number of countries that have such rules. The work will use a modular design allowing for maximum consistency but allowing for country specific needs and risks. One focus will be international tax schemes, where the work will explore using a wide definition of 'tax benefit' in order to capture such transactions. The work will be co-ordinated with the work on co-operative compliance. It will also involve designing and putting in place enhanced models of information sharing for international tax schemes between tax administrations.	September 2015
13. Re-examine Transfer Pricing Documentation	Develop rules regarding transfer pricing documentation to enhance transparency for tax administration, taking into consideration the compliance costs for business. The rules to be developed may include a requirement that MNE's provide all governments with needed information on their global allocation of the income, economic activity and taxes paid among countries.	September 2014

ACTION	DESCRIPTION	DEADLINE
14. Make dispute resolution mechanisms more effective	Develop solutions to address obstacles that prevent countries from solving treaty-related disputes under MAP, including the absence of arbitration provisions in most treaties and the fact that access to MAP and arbitration may be denied in certain cases.	September 2015
15. Develop a Multilateral Instrument	Analyse the tax and public international law issues related to the development of a multilateral instrument to enable jurisdictions that wish to do so to implement measures developed in the course of the work on BEPS and amend bilateral tax treaties. On the basis of this analysis, interested Parties will develop a multilateral instrument designed to provide an innovative approach to international tax matters, reflecting the rapidly evolving nature of the global economy and the need to adapt quickly to it.	December 2015

Appendix C: Summary of Submissions on Issues Paper

Responses on consultation questions

1. On 3 May an issues paper *Implications of the modern global economy for the taxation of Multinational Enterprises* was released for consultation and 28 submissions were received. The purpose of the paper was to seek views from stakeholders and the community more broadly to ensure the analysis in the Scoping paper captured and addresses the key issues.

2. The paper outlined the challenges that changes in the global economy pose to the international tax system. A key issue is whether tax concepts developed for the industrial age are still applicable in the era of the digital economy.

3. This summary seeks to capture the themes that emerged from the submissions in relation to the key questions posed. It also summarises other issues raised.

Q1: Should another country not exercising its right to tax concern Australia?

4. Submissions from industry groups and the practitioner community generally considered Australia should not be concerned if other countries do not exercise their taxing rights (or be concerned about the non-taxation of stateless income) as it is the right of these countries to choose what they tax.

5. Industry and the professions stated differential treatments under the international tax system can be unavoidable and don't necessarily indicate abuse but rather conscious policy decisions.

6. Civil society groups considered Australia should be concerned about whether other countries enforce their taxing rights. Pointing to the international benefits of assisting developing countries establish sustainable tax bases. These submitters pointed to the lack of enforcement of a country’s taxing rights sometimes being the result of capacity constraints and reduced levels of government accountability.

Q2: Evidence of Base Erosion and Profit Shifting in Australia?

7. The consultation question relating to the evidence of base erosion and profit shifting in Australia also sought comments on the limitations on establishing evidence and the potential costs and benefits of collecting further information.

8. Submissions from Industry and tax professionals commented that there was a lack of evidence that base erosion and profit shifting activities are currently impacting Australia. Further they commented that in addition to there being a lack of evidence they did not consider base erosion was occurring. That is, they considered that

under Australia's current legal framework profits that fall within Australia's tax base are being taxed accordingly. These submitters pointed to the Australia's robust tax laws and administration in support of this point (transfer pricing rules and Australia's general anti-avoidance rules were pointed to as examples).

9. Some qualifying comments were made acknowledging that inadequacies in the current international tax framework have led to some erosion of the traditional corporate tax base. There was general recognition that the rise of the digital economy and intangibles does raise some issues (but these issues need to be considered on a multilateral basis). There was general acknowledgment that historical basis for allocation of taxing rights may not be wholly suited to the digital economy.

10. Civil society submitters responded quite differently. They considered that there was significant evidence that base erosion and profit shifting was occurring and that the difficulty in arriving at an agreed aggregate level of the activity should not preclude action. Further these submitters discussed the important role that transparency measures could play in providing better information on which to assess the level and drivers of base erosion and profit shifting.

Q3: Did the OECD properly identify key pressure areas?

11. All submitters commented that the rise of the digital economy and intangibles present challenges that traditional tax settings may not adequately address. These comments were made in relation to both a jurisdiction's right to tax and broader allocation concepts.

12. While acknowledging the arbitrage opportunities of inconsistencies in global tax setting submitters pointed to the significant practical difficulties in resolving these issues comprehensively. This point was given emphasis by submitters who pointed out that differential treatment may also be a deliberate policy setting designed to attract mobile capital to their jurisdiction.

13. Civil society groups highlighted a need for increased use of transparency and disclosure measures and improved standards and a means of increasing awareness of pressure areas. For the extractive and resource industries, in particular, support was expressed for public disclosure of taxes paid (both on a country by country basis and a project by project basis).

14. Civil society groups also emphasised the importance of effective exchange of information arrangements as a means of combatting profit shifting.

15. There was a general consistency in comments that progressing solutions to these issues is best taken forward on a multilateral basis.

Other issues

Trade-offs

16. The submissions from business and the practitioner community commented that when addressing any integrity concerns with the corporate tax system the Government must also consider potential impacts solutions may have on Australia's continued ability to attract foreign investment.

Single entity taxation

17. Civil society groups suggest that single entity taxation of multinational enterprises could address some base erosion and profit shifting activities including the use of secrecy jurisdictions.

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