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Better Targeting the Income Tax Transparency Laws – Exposure Draft

Dear Sir/Madam

Ernst & Young (**EY**) welcomes the opportunity to provide our comments on the Exposure Draft of the *Tax and Superannuation Laws Amendment (Better Targeting the Income Tax Transparency Laws) Bill 2015* (**Draft Law**), which seeks to amend Australia's currently enacted income tax transparency measures (**tax transparency measures**).

We have expressed concerns in our previous public submissions in response to the:

- Australian Taxation Office (**ATO**) consultation paper titled "Tax secrecy and transparency: administrative arrangements for reporting entity information March 2015" (**ATO Paper**); and
- Treasury Discussion Paper "Improving the transparency of Australia's business tax system" (**Treasury Paper**) in 2013,

that the public reporting of 'total income', 'taxable income' and the 'income tax payable' of named corporate taxpayers whose total income is over $100 million, may lead to information being misused and misinterpreted, thereby eroding public confidence in the integrity of the current tax system. The enacted tax transparency measures also have the potential to tarnish the reputation of Australian businesses – even if they have good standing and relations with the ATO or other countries' revenue authorities.

We observe that the unhelpful nature of the disclosures is one reason for consideration of tax transparency initiatives such as the Government's proposed Voluntary Corporate Disclosure Code announced in the Federal Budget on 12 May 2015.

In any event, we strongly support the proposed exemption of Australian-owned private companies from having their tax information publicly disclosed by the ATO where the company satisfies certain requirements.

In this submission, set out in the Appendix, we provide our comments supporting the proposed exemption of Australian-owned private companies, and comment upon a number of technical and practical issues arising from the Draft Law for Treasury's review and consideration.

In summary:

- As Tax Commissioner Chris Jordan noted recently, the public reporting of Australian public company data, while this is a matter for government, serves no particular tax policy purpose. He was recently quoted in the media as stating that "If you look at the history of the matter, it was really for

multinational companies operating here". The opposition shadow Assistant Treasurer disagreed with this proposition, but it is telling that even the Commissioner considered that this particular disclosure does not serve any particular policy objective. This is notwithstanding that the Commissioner is strongly focused on enhancing ATO supervision and examination of the activities of multinational companies.

- From a commercial perspective, reporting private company tax payable and turnover data represents potentially significant commercial risk and disadvantage. Many private companies are providers of services and products to major corporate customers, with wholesale or supplier relationships. Private companies are more likely to be specialist suppliers of goods and services, to larger corporate customers, than are large public companies which are more likely to have diversified businesses, with data about particular business lines not able to be determined from their diversified financial reports. If details of turnover and taxable income for private companies are published, then competitors, customers (including large business customers) and other stakeholders may obtain information which can be used to exert commercial pricing or other leverage or advantages over private companies. This is all the more relevant as smaller private companies are often in a less strong position than widely held large public companies to resist such commercial pressure from competitors and big customers.

- The ATO public reporting will add unnecessary cost pressures for private companies and an additional regulatory cost and deadweight cost. Public reporting by the ATO, of turnover and tax payable, will allow commentators and advocacy groups to produce lists of private companies, and seek to tabulate private company groups by reference to their tax paid as a percentage of turnover, with potential adverse impact on reputation. Private companies will potentially face queries relating to any perceived low level of taxable income and low level of tax payable compared with their turnover. That information in the public arena will not explain the drivers of low taxable income which might include adverse trading conditions, or low yield capital assets, or large capital allowances or other incentives which reduce tax payable. While public companies have extensive public relations and public media support, private companies typically do not. Therefore, private companies will have significant new costs in preparing themselves and protecting their reputations, a deadweight cost for private company groups.

- Public ATO reporting does not apply to individuals on the basis of their human rights to privacy. But private companies also represent individuals, and their families. They are fundamentally different to widely held public companies: their affairs relate to family activities, and thus the individuals who are the owners of private companies should be entitled to the same human rights of privacy as are individuals more generally.

- Some commentators have noted there are public "rich lists" with information about private family wealth, but these look only at the top 100 or top 200 private groups in Australia. This ATO public reporting measure will potentially impact over 800 private companies, the bulk of which are not currently in the public arena. Again, this underscores the right to privacy of family individuals.

If you have any queries or wish to discuss, please contact Alf Capito on (02) 8295 6473 or Tony Stolarek on (03) 8650 7654.

Yours faithfully

Ernst & Young

APPENDIX

This submission contains our comments on the Exposure Draft of the *Tax and Superannuation Laws Amendment (Better Targeting the Income Tax Transparency Laws) Bill 2015* (**Draft Law**), which seeks to amend Australia's currently enacted income tax transparency measures (**tax transparency measures**).

Concerns about public tax reporting proposals more generally

EY's previous public submissions relating to the general ATO public reporting for affected companies, in response to the ATO Paper and Treasury Paper, expressed concerns that the public reporting of 'total income', 'taxable income' and the 'income tax payable' of named corporate taxpayers whose total income is over $100 million, may lead to information being misused and misinterpreted, thereby eroding public confidence in the integrity of the current tax system. The enacted tax transparency measures also have the potential to tarnish the reputation of Australian businesses – even if they have good standing and relations with the ATO or other countries' revenue authorities.

The submissions noted the global Base Erosion and Profit Shifting project, identified and actively pursued by the G20 group of countries, the less developed countries and the OECD, is correctly focused on the enhancement of the disclosures which multinational businesses must make to tax authorities, using Country by Country reporting. This is in addition to Australia's strong regime of:

- International Dealing Schedule disclosures by multinational businesses
- Australia's Reportable Tax Positions schedule and requirements
- Transfer pricing documentation requirements

overlaid onto the publicly available information required to be filed by public companies and their Australian subsidiaries.

ATO consultation about the public reporting has already identified the concern that the public reporting might actually be misleading, because it does not outline the many legitimate reasons for a company in business to have low tax payable. Causes, such as companies recovering from and using prior year losses, companies in challenging markets with low profit margins, companies with large capital allowance and R&D and other expenditures giving rise to tax deductions, companies receiving dividend income, etc. So the ATO is, we understand, to develop an extensive disclaimer or warning message to casual readers of the proposed public reports (but query whether any such ATO information will be reported by the media).

We also note the Government's proposed Voluntary Corporate Disclosure Code announced in the 2015-16 Federal Budget, which is to be developed in consultation with the business community. We submit that the Voluntary Corporate Disclosure Code recognises the shortcomings of the current ATO public reporting process.

Turning to the exclusion of private companies, recent comments by the Assistant Treasurer[1] re-affirm the continuing view of the damaging nature of the tax transparency measures which 'ignored the concerns of

[1] http://www.joshfrydenberg.com.au/guest/opinionDetails.aspx?id=183

key stakeholders, went against international best practice and will have damaging commercial and reputational ramifications for the individuals involved.'

We support exclusion of certain private companies

We welcome and strongly support the proposed exemption of Australian-owned private companies from having certain tax information published by the ATO where the company:

- is a resident private company
- is not a wholly-owned subsidiary of a corporate group ultimately held by a foreign resident company
- does not have a level of foreign shareholding greater than 50%.

We are of the view that the proposed exemption is necessary to mitigate the unintended effects of the current tax transparency measures, some of which we discuss below.

Australian private companies are not the intended target of the public tax reporting, and their inclusion serves no substantial policy purpose

Tax Commissioner Chris Jordan was quoted at some length in the media on March 19, 2015:

> *"Tax commissioner Chris Jordan said laws aimed at requiring the tax office to publish the tax information of large companies were originally intended to capture multinationals, not private companies.*
>
> *But Labor's shadow assistant treasurer Andrew Leigh said private companies were a target of the laws when introduced, suggesting it wasn't appropriate for the commissioner to comment on policy intention.*
>
> *The Coalition wants to remove about 700 private companies from laws …Asked about the rollback, Mr Jordan, speaking at the Tax Institute conference on Queensland's Gold Coast, said "it's clearly a matter for government".*
>
> *But he said the laws were originally intended to capture overseas-based multinationals that were not paying tax on billions of dollars of sales in Australia, rather than private business owners.*
>
> ***"I think if you look at the history of the matter, it was really for multinational companies operating here, disclosing quite low revenue," he said.***
>
> *"I understand, and this mainly what I've read in the media, that there's a lot of concerns about the private companies [being included] in these disclosures. [There are] personal reasons but also competitive reasons. People saying, well their [private companies'] margins might be looked at. If they're a major supplier to some of the major retailers there might be pressure on them to reduce their prices." (emphasis added)*

It is telling that even the Tax Commissioner personally considers that this particular disclosure does not serve any particular policy objective. This is notwithstanding that the Commissioner is strongly focused on enhancing ATO supervision and examination of the activities of multinational companies and

enhancing Australia's laws in this area. The Commissioner's personal comments suggest that the tax reporting of Australian private company information serves no substantial policy purpose.

The information being publicly disclosed is most likely to be misinterpreted and misused and it is our view that any public benefit obtained from these public disclosures will not outweigh the commercial, reputational, personal risks, or potential increased inefficiencies to the tax system flowing from the existing tax transparency measures.

ATO public reporting is likely to be misleading

The ATO public reporting is likely to be misleading and will result in costs to be borne by all affected companies to counter misperceptions of their real tax contribution.

We highlight this issue because, as outlined below, private companies are less well equipped than public companies to deal with public media interactions. As a result the public reporting will impose greater cost pressures on them.

The publicly disclosed information is commercially sensitive which could disadvantage the company

Commercially, reporting private company turnover and taxable income data potentially exposes those businesses to significant commercial risk and disadvantage.

Unlike large public companies (with potentially multiple and/or diverse businesses) and which deal extensively with the public, many private companies are more specialised providers of services and products, providing the services and products to larger businesses.

If details of turnover and taxable income are published then competitors (including foreign), customers (including large business customers) and other stakeholders may obtain access to information which can be used to exert commercial pricing or other leverage or advantages over private companies. Private companies are in a less strong position than widely held large public companies to resist such commercial pressure.

As the Commissioner of Taxation put it:

> *"I understand, and this mainly what I've read in the media, that there's a lot of concerns about the private companies [being included] in these disclosures. [There are] personal reasons but also competitive reasons. People saying, well their [private companies'] margins might be looked at. If they're a major supplier to some of the major retailers there might be pressure on them to reduce their prices."*

Reputational or personal concerns flowing from the public disclosure should not be trivialised

Concerning reputational risks, we repeat our concerns from our submission to the Treasury Paper that the public disclosure could be used by some parties to create "name and shame" campaigns and unfairly and inappropriately attack the reputation of legitimate businesses that comply with Australia's tax laws and have good relationships with the ATO.

This concern is particularly relevant in the context of private company groups which do not maintain large public-affairs and public relations operations as do public companies.

The information in relation to turnover and tax payable for private companies will allow commentators and advocacy groups to produce lists of private companies, and seek to tabulate private company groups by reference to their tax paid as a percentage of turnover, with potential adverse impact on reputation. That information in the public arena will not explain the drivers of low taxable income which might include adverse trading conditions, or low yield capital assets, or large capital allowances or other incentives which reduce tax payable.

While public companies have in place larger public relations and public media support, private companies do not: so private companies will have significant costs in preparing themselves and protecting their reputations, causing a deadweight cost for private company groups.

Some commentators have noted there are public 'rich lists' with much of this information about private family wealth. But the public rich lists look only at the top 200 private groups in Australia, whereas the ATO public reporting measure will, we understand, impact over 800 private companies, the bulk of which are not currently in the public arena. Again this underscores the right to privacy of family individuals.

Unlike current reporting of a small number of groups in 'rich lists', the information disclosed will not merely be an estimate but will reveal actual information about the owners' financial affairs. Whilst this issue has been downplayed by the media, this is a real concern for a number of private companies and family groups which have raised their concerns with us.

Certain private companies are required to lodge public financial reports under Section 292 of the Corporations Act 2001.[2] However, various private companies are not required to lodge financial reports with ASIC, or are exempt from doing so. We submit that similar policy considerations which apply to private companies not having to lodge public financial reports be considered and applied to the proposed tax transparency measures. This may include, for example:

- Benefits of companies operating as a proprietary company versus a public company, where the former has less stringent reporting requirements.
- Affairs of companies should not be disrupted by regulatory change, unless the public benefit significantly outweighs the various costs to the company.
- Loss of commercial privacy, which may also reveal the private affairs of the company's owners.

Japan's abolition of public reporting of taxes is relevant

Japan's tax laws previously had a public reporting requirement under each tax law: for example, a corporate tax disclosure (taxable income disclosure) rule was provided under Art. 152 of Japan's national corporate tax law. These disclosure rules were introduced in 1950, which required public reporting of corporate tax, individual tax, and inheritance tax. Japan, however, abolished the disclosures in 2006 after a wide-ranging 2005 report of the Japan Tax Advisory Commission. The abolition of the

[2] Discussed on the ASIC website here http://asic.gov.au/regulatory-resources/financial-reporting-and-audit/preparers-of-financial-reports/financial-reports/
- the legislation link is http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/s292.html

disclosure rules was contained in the Tax Advisory Commission's Report[3] for the 2006 tax reform (issued in Nov. 2005).[4] (**TAC Report**)

The last chapter of the TAC Report noted that the policy underlying the public reporting had been to impose a restraining effect on tax practices by monitoring by the public, but it had effects outside the intended purposes. While this was not expressly stated in the TAC Report, we understand these were seen as including harassment including the use of the information by marketers and fund-raisers to target their marketing campaigns.

In addition, Japan had a public policy of introducing greater privacy of personal information by introducing a Personal Information Protection Law[5], which demanded more appropriate handling of information held about individuals and private and public businesses by government agencies.

In light of these factors, the Tax Advisory Commission recommended that the disclosures be abolished. This was implemented in 2006.

Human rights issues

We agree that, as legislated, public reporting should not apply to individuals on the basis of their human rights to privacy.

However, private companies are typically closely held and thus represent individuals or family groups. We find it difficult to differentiate on human rights grounds between individuals conducting business or earning high incomes (who obtain privacy with which we agree) and individuals conducting business in private companies, which are denied similar privacy.

Private companies are fundamentally different to widely held public companies: the affairs of private companies relate to individuals and family activities, and in our view they should be entitled to the same human rights of privacy accorded to individuals.

Avoiding the distractions for private companies

In addition, and as disclosed in paragraph 1.17 of the Explanatory Material to the Draft Law (**EDEM**), the ATO's public reporting of private company information may result in companies restructuring their affairs keep below the $100 million threshold. The tax transparency measures potentially encourage taxpayers to establish additional companies and implement complex structures to avoid disclosure. This unintended impact only adds to the compliance costs for the ATO and taxpayers, and creates further inefficiencies in the tax system.

In our view Australia's tax system should be encouraging private companies to invest and to develop their businesses, and not to develop regulatory and disclosure obligations which cause private companies to be distracted into consideration of their privacy and planning to protect their privacy.

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3 http://www.cao.go.jp/zeicho/tosin/171125a.html. See also http://www.cao.go.jp/zeicho/gijiroku/b45kisoa.html (Tax Commission Basic Issues Small Advisory group meeting minutes 11 November 2005)

4 http://www.cao.go.jp/zeicho/tosin/171125b2-9.html. The abolition is stated in the second paragraph of the last chapter of the report, '9. Tax Administration.'

5 Protection of Personal Information Act No. 57 of 2003: http://www.cas.go.jp/jp/seisaku/hourei/data/APPI.pdf

Foreign closely held private companies should also be excluded

We observe that the Draft Law proposes exclusion only for private companies owned or controlled by Australian residents. We submit that consideration could be given to extending the exclusion to 'closely held' private companies that are ultimately owned by foreign individuals for similar reasons that we have outlined above, being:

- The discouragement of foreign resident individuals from investing into Australia
- The unnecessary introduction of information into the public arena that has always been private
- Due to the business affairs relating to family activities, these foreign resident individuals of closely held private companies should be entitled to the same human rights of privacy accorded to individuals

Technical and Practical Issues

We support the conditions for exclusion being driven by ATO company tax return instructions

The EDEM adopts the interpretive approach of basing the conditions for disclosure on information gleaned from company income tax returns prepared using the ATO company tax return instructions, as (EM para 1.23) 'Using this existing information also ensures that these amendments do not impose additional compliance costs on taxpayers.'

We support this approach: it is an effective drafting and compliance approach compared with the alternative of legislating to introduce a complex array of new 'hard-wired' provisions and definitions which might not align to the ATO instructions.

Exemption from disclosure – test time(s)

Proposed subsection 3C(1) of the *Taxation Administration Act 1953* (**TAA**) contains carve-outs which exempt a taxpayer from having certain tax information publicly released by the ATO. To be exempt, the taxpayer must not meet any of the three requirements in proposed subparagraph 3C(1)(b) of the TAA.

Subparagraph 3C(1)(b) of the TAA requires the taxpayer to assess their *exemption* eligibility by reference to the income year.

We submit there is ambiguity surrounding the point(s) in time over which the eligibility requirements are to be tested against for 2 out of the 3 requirements.

For 2 of the 3 requirements in proposed subsection 3C(1) of the TAA, being the:

- entity was not an Australian resident private company for the income year; and
- the entity was a member of a wholly-owned group during the income year that has a foreign resident ultimate holding company,

it is not clear whether the entity is required, in order to be exempt from the tax transparency measures, to satisfy the conditions for a **part** or **whole** of the income year, or **as at the end** of the income year.

On this issue, we submit that:

- the proposed tax transparency measures should test the above subparagraph at the income year end to minimise the compliance burden on the ATO and the taxpayer; and
- guidance should be developed to clarify the testing time in the legislation itself, or either one or both of the ATO's administrative practice and the explanatory memorandum to the enabling legislative Act.

The EDEM provides that 'all of the information used to determine whether the conditions [for the exemption] are satisfied is collected from taxpayers on the company tax return.'

Implicitly, the information that is used to make that assessment is based as at the income year end, which may not take into account events occurring during the income year. For example, an entity may have been a member of a wholly-owned group during the income year (for proposed subparagraph 3C(1)(b)(ii) of the TAA purposes) but not at the end of the income year. In this simple example, and because the assessment of the exemption is implicitly based on information at the income year end, the entity may fall out of the tax transparency measures when it should, under current drafting, be caught by the tax transparency measures.

We believe that a clarification on the testing time, as submitted above, should resolve this particular practical issue.

Clarification about ultimate ownership

A resident private company can have its information publicly disclosed if "the entity was a member of a wholly owned group during the income year that has a foreign resident ultimate holding company." (proposed s3C(1)(b)(ii). So the requirement is for foreign resident characteristics for the ultimate holding company, not mere foreign incorporation. We agree.

Disclosure is required also, under proposed s.3C(1)(b)(ii) if 'the percentage of foreign shareholding in the entity was greater than 50% at the end of the income year.'

We submit that this provision should refer to foreign resident shareholding, to be consistent with s3C(1)(b)(ii).

Also, the discussion in the EDEM about the testing of foreign ownership is not clear. We think it is important to have the issue clarified, using upcoming ATO company tax return instructions. That would be consistent with using the ATO form C instructions as the definitional mechanism for purposes of this legislation.

This may require further consultation, to which we would be happy to contribute.