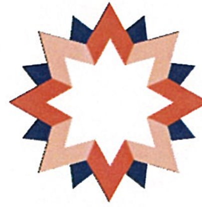

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2 July 2015

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

Dear Sirs

BETTER TARGETING THE INCOME TAX TRANSPARENCY LAWS

The Rule of Law Institute of Australia (RoLIA) welcomes the opportunity to engage with Treasury and provide a Submission on the Exposure Draft Tax and Superannuation Laws Amendment (Better Targeting the Income Tax Transparency Laws) Bill 2015 (Draft Bill) and accompanying Exposure Draft Explanatory Memorandum.

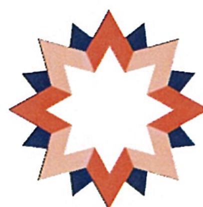
In May 2013, RoLIA provided a detailed submission (Earlier Submission) to Treasury in response to the Treasury Discussion Paper *Improving the Transparency of Australia's Business Tax System* issued in April 2013 (Discussion Paper) and this Submission builds on that Earlier Submission, specifically in response to the Draft Bill.

RoLIA was founded in 2009 as an independent not-for-profit body formed to uphold the rule of law in Australia. RoLIA aims to promote discussion on, to raise awareness of, and encourage active adherence to, the principles which underpin the rule of law. We thank you for considering this Submission to the Draft Bill, and the fundamental rule of law issues which arise in respect of it.

We would value the opportunity to discuss any aspects further with you.

Kind regards

Robin Speed
President



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TAX AND SUPERANNUATION LAWS AMENDMENT (BETTER TARGETING THE INCOME TAX TRANSPARENCY LAWS) BILL 2015 – EXPOSURE DRAFT

This submission is comprised of three parts. Firstly, it discusses RoLIA's support for the amendments proposed in the Draft Bill as it is a significant improvement to ameliorate the injustice and discrimination caused by the current tax disclosure laws. Secondly, it is observed that despite the positive changes proposed in the Draft Bill, the current tax disclosure laws continue to breach fundamental rule of law principles and will not likely achieve the intended policy. Thirdly, this submission addresses some minor clarification to the drafting of the Draft Bill.

Part 1 – RoLIA supports the Draft Bill

RoLIA welcomes the amendments to the Taxation Administration Act 1953 (Act) proposed in the Draft Bill. Proposed new section 3C(1) of the Act is a crucial and significant improvement to the tax publication provisions inserted in 2013. The proposed new section 3(1) will appropriately reduce the group of taxpayers which are subject the current income and tax disclosure laws which RoLIA considers are unfair and discriminatory for the reasons set out in the Earlier Submission.

The explanatory memorandum (EM) to the Draft Bill outlines four main reasons why the changes are necessary for private companies:

1. The disclosures can reveal commercial information of a private company and undermine its ability to engage in proper commercial negotiations;
2. The disclosures may compel private companies to restructure their corporate groups in order to fall below the disclosure threshold;
3. The disclosures would lead to additional costs and compliance burden to private companies in having to justify the tax information to the public; and
4. The disclosures can negatively impact on the personal privacy and security of the shareholders of private companies.

RoLIA agrees with these reasons – which demonstrate that the current disclosures laws not only discriminate against private companies and their shareholders, but it also led to unjust outcomes by distorting the allocation of resources of private companies. These are discussed in turn.

Removes discrimination against shareholders of private companies

As set out in detail in RoLIA's Earlier Submission, the income and tax disclosure laws introduced into the Act in 2013 are discriminatory because it not only discloses the confidential tax information of private companies but has the propensity to breach the fundamental right to tax privacy of the individual family shareholders of those private companies – where those rules apply only to companies and not other forms of tax entity, and where those rules target specifically companies which exceed a set annual income amount.

For private companies in particular, public disclosure of their income and taxation affairs is tantamount, in the eyes of the public, to disclosure of the personal income and taxation information of the owners of those businesses. In most instances, it is relatively easy to identify the owners of such businesses, and the families connected with them, by searching through the ASIC register for the names of officers and shareholders of the relevant companies and their shareholder entities.

This can be contrasted to public and widely held companies, which may be owned by a multitude of entities, including institutional investors, foreign entities and entities through nominee arrangements rather than direct ownership – in which case the details of such shareholdings would not be publicly available.

The current tax disclosure laws are a fundamental reversal of the principles of taxpayer secrecy which have long been enshrined in Australia's taxation laws with particularly onerous ramifications on private Australian companies and their owners simply because their gross accounting income exceeds an arbitrary threshold.

As noted in the EM and acknowledged by the Assistant Treasurer the Honourable Josh Frydenberg MP in his Opinion Article published in the Australian on 16 June 2015 (Opinion Article), the current disclosure laws potentially give rise to "reputational or personal safety concerns"[1] for shareholders of private companies. This argument is supported not only by high profile individuals and family groups in the Australian community who have expressed concern, but by the experiences of Japan which had a similar disclosure regime but was abandoned in 2005 after reported findings that the laws were a factor in causing crimes and harassment.[2]

Further, the disclosure of private tax information of a private company may be commercially sensitive and cause disadvantage to its competitive position. The argument was aptly put by Mr Frydenberg MP in his Opinion Article, when he provided an example where *"a company which sells to only one or two major customers could find that the information is used to work out its profit margins, putting it in a weaker position during price negotiations."*

The current disclosure laws have broad implications and without the amendments in the Draft Bill, would continue to discriminate against private companies and their shareholders and lead to adverse consequences for such taxpayers and individuals.

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[1] *Why we need to wind back Gillard's damaging legislation on company tax disclosure*, Josh Frydenberg MP, The Australian 16/6/2015

[2] See paragraph 1.12 of the EM.

Removes distortion of allocation of resources of private companies

The amendments proposed by the Draft Bill will also remove potential distortion of allocation of resources by private companies. That is, in order to avoid the unfair reversal of Australia's long held principles of taxpayer confidentiality, private companies may be compelled to restructure their corporate groups in order to fall below the $100 million threshold. Restructuring on this basis may lead to inefficiencies and unnecessary deployment of resources simply to avoid public purview. This leads to an unjust outcome as such private companies would be at a competitive disadvantage compared to other taxpayers that are not subject to the disclosure laws.

Further, as discussed in RoLIA's Earlier Submission, in practice private companies would suffer additional compliance costs in justifying or attempting to explain their income and tax position to the public, when the corporate taxation system is inherently extremely complex. The amendments in the Draft Bill would save significant time and resources for private companies which can be better utilised rather than dedicated towards unnecessary compliance burden.

RoLIA believes that the amendments proposed by the Draft Bill successfully limit those unfair and unjust consequences to those class of taxpayers that are most adversely affected by the current disclosure laws – private Australian companies and their individual and family group shareholders.

Part 2 – Ongoing pitfalls of the current disclosure laws

Whilst the amendments in the Draft Bill ameliorate the current disclosure laws, particularly for private Australian companies and their owners, RoLIA maintains that the remaining provisions continue to be inconsistent with the rule of law, as they otherwise discriminate against certain public and foreign owned companies (and not trusts, partnerships or other entities) and will likely fail to achieve the stated policy of generating proper public tax debate.

Public disclosure of selected aspects of the income and taxation of those companies – the gross accounting income, net taxable income and Australian tax payable – would not likely "discourage large corporate tax entities from engaging in aggressive tax audit practices", nor "provide more information to inform public debate about tax policy" – the information which would be published does not provide any demonstrative information to explain tax policy or engage a debate about it, nor is there any indication that such information would discourage large companies from engaging in aggressive tax avoidance. Rather, the expected effect of those laws would be a "naming and shaming" in the press without any explanation as to the fundamental differences between gross income or accounting purposes, and net taxable income.

Since the Discussion Paper was released in April 2013, both the Treasury and the Australian Taxation Office (ATO), as well as numerous industry bodies, have acknowledged the lack of ability in such a disclosure law generating meaningful public tax debate. The Treasury and the ATO themselves have noted that comparison of accounting and net taxable income is fundamentally different and potentially dangerous. At a Senate Estimates Hearing on 22

October 2014, ATO Second Commissioner Mr Neil Olesen said that comparing accounting profit to taxable income was "meaningless to the extent that taxable income and accounting profits are two fundamentally different concepts, so you cannot draw a conclusion". He also stated that such comparison creates incorrect perceptions of effective tax rates, which is "an unfair impression to leave, and a damaging one from a tax administrator's view".

Executive Director Revenue Group of the Treasury Mr Rob Heferen stated at that Hearing that comparing accounting profit and taxable income is like "comparing an apple with an orange and it not being about fruit". He also stated that discussion focused solely on the comparison between gross accounting income and net taxable income "is fundamentally a misunderstanding of what taxable income in Australia ought to be about".

ATO Second Commissioner Mr Andrew Mills went further to give examples of key and fundamental differences between accounting and tax, and of tax credits, and tax policies which without detailed technical explanation would be entirely misleading.

The compliance costs and reputational risks for such companies endeavouring to explain Australia's highly complex corporate tax system in the press has no justification. To apply those laws, and that level of public scrutiny, to only one type of taxpayer entity – companies, and not trusts, partnerships, individuals, or otherwise – and only to those which exceed a certain threshold, creates a disproportionate and discriminatory rule which would be applied only against those companies who fall into the narrow class.

Part 3 – Suggested minor clarification

The proposed new section 3C(1) will limit the disclosures to exclude Australian resident companies which do not have a foreign ultimate holding company, or foreign shareholdings exceeding 50%.

For this purpose Australian resident companies, private companies, and ultimate holding companies are defined by reference to the Income Tax Assessment Acts. However "foreign shareholding in the entity" (proposed section 3C(1)(b)(iii)) is not a defined term. It is not clear from that phrase whether direct as well as indirect shareholdings are to be taken into account.

The Exposure Draft EM states that the Commissioner of Taxation will determine this from company tax return disclosures, which are based on company tax return instructions.

RoLIA submits this would be more appropriate to define in the Taxation Administration Act for this purpose rather than rely solely on the Commissioner's tax return instructions, which are potentially liable to change and are not determined by the Parliament. The principles of the rule of law require the law to be known, readily ascertainable, and available to taxpayers. RoLIA submits that "foreign shareholding" in an entity should accordingly be defined in legislation, for this purpose.

Conclusion

RoLIA welcomes the proposed new section 3C(1) of the Act set out in the Draft Bill, to restrict the discriminatory and unjust tax disclosure rules from applying to private Australian companies – entities which would feel it most keenly.

RoLIA commends the Draft Bill and the amendments to the Taxation Administration Act contained in it.