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Dear Sir or Madam

**Submission on Issues Paper on the Implications of the Modern Global Economy for the Taxation of Multinational Enterprises.**

CPA Australia represents the diverse interests of more than 144,000 finance, accounting and business professionals in 127 countries. Our vision is to make CPA Australia the global accountancy designation for strategic business leaders.

Against this background we provide this submission concerning the Issues Paper entitled 'Implications of the Modern Global Economy for the Taxation of Multinational Enterprises' (the Issues Paper) released by Treasury on 3 May 2013.

**General Comments**

As an overarching comment we believe that Australia's current headline corporate tax rate of 30% is a significant impediment to companies conducting business and investment in Australia as it is now relatively uncompetitive internationally.

Accordingly, any analysis as to why current company tax revenue collections are less than those forecasted by Treasury in prior years should recognise that many multinational corporate groups may often be deterred from trading and/ or investing in Australia as their profits may be more concessionally taxed in other jurisdictions.

This is especially important as the location of capital, debt, labour and intellectual property are increasingly mobile in the evolving digital economy.

CPA Australia has long advocated that the Australian corporate tax rate should be substantially reduced to be more internationally competitive. We believe such a measure is one of the key drivers which would increase entrepreneurial behaviour and national productivity in Australia. This view is broadly congruent with the terms of Recommendation 27 of 'Australia's Future Tax System: Final Report' issued by Treasury on 2 May 2010 which stated that '… the company income tax rate should be reduced to 25 per cent over the short to medium term…'.

We also acknowledge the recent review of corporate tax rate by the Business Tax Working Group[1]. Disappointingly, the outcome of this review has not resulted in any reduction in the corporate tax rate. Instead, it appears some of the ideas in the final report has been cherry-picked to reduce business access to certain tax concessions, for example via tightening of the thin capitalisation rules. Business has also been subject to other reductions in access to tax concessions including the R&D tax incentive and exploration expenditure deductibility.

We strongly contend that the need to cut the Australian corporate tax rate to a more internationally competitive rate is now one that needs to be at the forefront of any debate on national tax reform.

We recognise that the cost of effecting such a major tax reform would be considerable. In the absence of any other plausible option, we consider such an initiative must consider either broadening the base of Australia's Goods and Services Tax (GST) and/ or to increasing the GST tax rate. It is well known that Australia's GST rate is currently amongst the lowest imposed by countries who are members of the Organisation for Economic Co-operation and Development (OECD).

[1] http://www.treasury.gov.au/PublicationsAndMedia/Publications/2012/BTWG-Draft-Final-Report

Notwithstanding our comments above regarding reasons why the tax take may be lower, we concur with the view expressed in the Issues Paper that to some extent there appears to have been an erosion in the traditional corporate tax base of advanced economies such as Australia which has been triggered by the inadequacies of the current international tax framework.

This is especially relevant in relation to the longstanding international tax principles concerning the sourcing of profits which appear increasingly outmoded in a knowledge based global economy where the source of profits will not be as contingent on a fixed physical presence as has been conventionally the case in the past.

We therefore support any coordinated and methodical review of the fundamental concepts underpinning the tax treatment and characterisation of cross border transactions if it is undertaken on an multilateral basis such as by the G20 group to determine if a robust and equitable tax infrastructure can be developed in respect of 'virtual' permanent establishments to address the mobility of intellectual property and finance.

While the G20 discussions and commitment are important, it would be reckless for governments, including the Australian Government to do nothing in the meantime. We also note it will be virtually impossible for all countries to sign up to some joint agreement in this regard as long as countries compete for business and investment.

As a corollary we believe that the range of recent tax initiatives announced by the Federal Government including those specified in the 2013-2014 Federal Budget to deter international profit shifting or tax arbitrage opportunities are in aggregate sufficient to ensure that measures Australia is taking are appropriate but exercise caution about others that may be contemplated at a later time.

**<u>Specific Comments</u>**

We provide the following specific comments in respect to the Issues Paper:

### 1. Magnitude of the Problem

As stated earlier in this submission there appears to have been an erosion of the traditional corporate tax base of advanced economies such as Australia which has been triggered by the inadequacies of the current international tax framework. We also appreciate that it would be difficult to identify any discrete comparative data to demonstrate the magnitude of base erosion and profit shifting (BEPS) in Australia based on current sources of information collated from corporate income tax returns and other data sources. However, we note that no specific evidence is presented in the Issues Paper to indicate that BEPS is, in fact, taking place in Australia.

Indeed, the primary argument advanced to suggest that there may be BEPS in Australia is the observation that gross business profits appear to have recovered to the level expected before the global financial crisis of 2008, but that company tax collections have not.

Whilst we recognise that the modelling undertaken to support this assertion no doubt has many complex facets to it, we note that there may be an array of reasons as to why corporate tax collections have not recovered to a level which is commensurate to the recovery of gross business profits, and that such a differential outcome is not necessarily due to BEPS.

Firstly, many companies which legitimately incurred tax and capital losses during the global financial crisis may now be in the process of wholly or partly recouping them. Indeed, such an outcome would be consistent with the recovery in the effective tax rate for the 2011-12 tax year shown in Chart 4 of the Issues Paper which suggests that the recoupment of losses may be tapering off as some companies substantially recoup such losses.

Secondly, the recovery in gross operating profits post the global financial crisis is different to many earlier economic recoveries in that the economy was being stimulated by an unprecedented investment in mining infrastructure and investment rather than by a consumer led recovery. Accordingly, much of the spend by business has been deductible, depreciable or GST creditable thereby reducing company tax revenue collections whilst a consumer led recovery would typically result in the acquisition of goods and services which would typically generate incremental income tax and GST tax collections.

Thirdly, in the aftermath of the global financial crisis certain tax measures were introduced to stimulate the economy. It is not clear how gross operating surplus in Chart 3 of the Issues Paper is measured, but assuming that it is based on financial accounting profit, these special concessions represent a permanent difference between profits for accounting purposes and taxable income upon which tax is calculated.

Thus, whilst some diminution in the anticipated corporate tax collections may be due to BEPS it would be imprudent to take further immediate unilateral action until more clarity as to the scope of such an exposure is clarified.

We also note that the observation in paragraph 64 of the Issues Paper that Australia's corporate tax collections have recovered less than that of company tax receipts recovered by other countries may similarly be due to a variety of reasons and does not of itself suggest BEPS.

For example, many other jurisdictions during the period modelled had established loss carry back rules which would allow companies to carry back a loss to apply against prior year profits including those profits which were derived in tax years prior to the global financial crisis where companies in most comparative tax jurisdictions were typically profitable. Accordingly, the quicker utilisation of tax losses in those jurisdictions must affect any comparability with the recoupment of tax losses with Australia which did not have any loss carry back regime during the period tested.

Finally, the Issues Paper notes that many of the perceived shortcomings of the existing international tax framework arise due to the mobility of intellectual property. However it is unclear to what extent any movement of intellectual property to other tax jurisdictions has had an overly detrimental impact on the Australian tax revenue base. Indeed, the information on intellectual property charges discussed in paragraph 69 of the Issues Paper states that the amounts paid for the use of such property has been relatively small and broadly constant as a share of GDP over the past 12 years hovering around 0.25% of GDP.

For all of the above reasons we believe that there is insufficient data to reach a definitive view of the magnitude and nature of BEPS in Australia. We would therefore support targeted measures to increase the collation of further sources of data to help shed light on the scope of BEPS in Australia provided care was taken to ensure that there was not any duplication of data gathering processes and that it did not apply to smaller company groups which are less likely to be engaged in international profit shifting of the kind referred to in the Issues Paper.

**2. Unilateral action to address key pressure areas**

Paragraph 78 of the Issues Paper broadly highlights five 'key pressure areas' identified by the OECD which represent the most immediate and pressing problems to be addressed under BEPS.

These five areas comprise:

1. Increased transparency to better understand BEPS.
2. Tackling tax arbitrage opportunities from international mismatches in entity and instrument characterisation.
3. Addressing the tax treatment of debt and other intra-group financial transactions to prevent BEPS.
4. Dealing with uncertainty on where production occurs in a digital economy, including the role of intangibles and
5. Anti-avoidance measures (including addressing harmful tax practices).

We note that the Federal Government has already unilaterally introduced a raft of measures to address most of these concerns.

For example:

1. The proposed changes to section 23AJ of the Income Tax Assessment Act (1936) (the ITAA (1936)) and the proposed repeal of section 25-90 of the Income Tax Assessment Act (1997) (the ITAA (1997)) announced in the 2013-2014 Federal Budget are measures which are clearly directed at limiting tax arbitrage opportunities in respect of certain hybrid instruments as is the announced review of the debt and equity provisions under Division 974 of the ITAA (1997) by the Board of Taxation
2. Concerns regarding excessive intra- group debt deductions being claimed in Australia have also been addressed under the various proposed changes to the thin capitalisation provisions under Division 820 of the ITAA (1997).
3. The proposed amendments expanding the scope of the general anti-avoidance provisions of Part IVA of the ITAA (1936) and the application of the transfer pricing provisions in Subdivisions 815-B to 815-D of the ITAA (1997) as set out in the Tax Laws Amendment (Countering Tax Avoidance and Multinational

Profit Shifting) Bill 2013 are designed to prevent perceived avoidance practices and limitations of the existing regime.

Taken together with the increased data that may be collected to determine the transparency of corporate behaviour and the incidence of BEPS, the only material key pressure area that still needs to be addressed is to revisit the concepts of source and residence which we submit must only be undertaken where there is a multilateral consensus to do so.

Given previous attempts to resolve uncertainty regarding the treatment of capital gains under Australia's various double tax agreements under bilateral discussions for over a decade we recognise how challenging it can be to obtain consensus on international tax reform.

However, in our view any further unilateral action such as broadening the scope of the controlled foreign company provisions in Part X of the ITAA (1936) to, say, tax active business income on an accruals basis would be disastrous at a time when the Australian corporate tax regime is struggling to be internationally competitive and is still coming to grips with a range of profound tax reforms.

Indeed, some of the above announced reforms may in fact have already considerably stifled Australian business and constrained transactional activities with the consequential result that less taxable income has paradoxically been derived.

In this context it is to be particularly noted that clarity on the proposed operation of the amended general anti-avoidance provisions of Part IVA is urgently required as they remain incomprehensible to many in the tax profession let alone the broader community.

It should also be noted that at present neither the United States of America or the United Kingdom have an equivalent general anti-avoidance provision (although we acknowledge the UK is about to introduce one) even though they are often referred to as potential benchmark jurisdictions when considering the magnitude of BEPS.

### 3. Double non-taxation

One of the issues canvassed in the Issues Paper is whether Australia should be concerned if double non-taxation arises due to another jurisdiction failing to fully exercise their right to tax an amount of income.

Like many of the matters canvassed in the paper we acknowledge that this is a complex multi-faceted issue.

However, we believe care should be taken in exploring this issue where Australia does not generate any taxable income from a particular business activity because it is concessionally taxed in another jurisdiction.

This is because Australia itself has introduced tax concessions which are not necessarily replicated in other jurisdictions. For example, the exemption from capital gains tax available to non-residents in respect of the application of the capital gains tax provisions, other than in respect of certain taxable Australian real property, under Subdivision 855-A of the ITAA (1997) may be seen as non-taxation by those jurisdictions which do not have an equivalent regime.

Hence, it would be detrimental to the impact of required overseas capital inflows if these provisions were repealed merely because there was a global attempt to prevent double non-taxation.

Moreover, in pragmatic terms we do not envisage that there will ever be an international consensus to achieve such reform.

If you have any questions regarding the above, please contact Mark Morris, Senior Tax Counsel, on (03) 9606 9860 or via email at mark.morris@cpaaustralia.com.au.

Yours faithfully

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