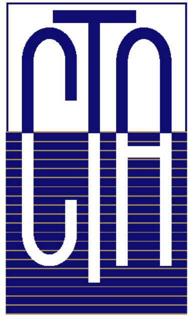

Response to Discussion Paper

Improving the transparency of Australia's business tax system

Corporate Tax Association of Australia Inc.

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24 April 2013

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Via e-mail: taxtransparency@treasury.gov.au

Response to Discussion Paper
Improving the transparency of Australia's business tax system

The Corporate Tax Association (CTA) welcomes this opportunity to comment on Treasury's recent Discussion Paper (DP) about transparency.

The CTA is supportive of the notion of having a high level of transparency around the tax performance of large companies. Indeed, many large companies already publish quite detailed tax information and most large companies operating in Australia are justifiably proud of the contribution they make to the broader community as measured by their tax performance.

However, we are concerned that the tax data the Commissioner of Taxation would be required to publish annually will be incomplete and potentially misleading, leaving it open to either deliberate or inadvertent misinterpretation. We do not believe that the proposal will enable the community to draw informed conclusions about whether or not any particular company is paying its "fair share" of tax, whatever that means. This is likely to run counter to one of the intended outcomes of the proposal, which is to avoid undermining community confidence in the integrity of Australia's tax system or reducing the level of voluntary compliance[i].

While the proposal to require the ATO to publish certain information from its taxpayer records would not directly impose additional compliance costs on business, the practical outcome is that most large companies would need to give serious consideration to avoiding misunderstandings or mischief by publishing more detailed narrative information about their tax performance that users would at least be able to make some sense of. Accordingly, claims that this proposal would not add to business compliance costs are not accurate.

We have no particular issues with the second and third proposals raised in the DP, relating to publishing aggregate tax collection data and sharing information with other agencies for the purposes of administering the *Foreign Acquisitions and Takeovers Act 1975.*

The data proposed to be published are likely to be misleading

If any data is required to be published, we would prefer to minimise the scope for misunderstandings by disclosing the net income tax payable and not total income. Total income bears little or no relationship to taxable income, given that different businesses typically have quite different gross profit margins and levels of taxed foreign income. In our view, it would be unhelpful to have financial journalists or others make a 'story' out of the fact that a particular company may have paid only a certain percentage of their total income in tax if they operate on a very narrow gross margin or where much of their profits are sourced in comparably taxed countries and they comply with Australia's transfer pricing rules.

Listed companies publish plenty of audited information explaining the relationship between their total income and their net profit, and unlisted reporting entities are required to make ASIC filings that do likewise. Information about gross income and its relationship to net profit is readily available to anyone who cares to look for it. Even Denmark, which we believe is the only other country which has gone down this path, does not disclose information about total income – presumably because they recognise its limitations and the potential it has to create misunderstandings.

We would have expected the DP to look at publishing information about reported net income before tax, which in our view would be more meaningful than total income. Even if the total income part of the disclosure proposal is abandoned, as it should be, users of the information published under this proposal will in most cases still not be able to work out the actual tax performance of affected companies without some kind of voluntary disclosure of additional contextual information by those companies.

Even sophisticated users would be hard-pressed to draw any meaningful conclusions about a company's tax performance without having access to detailed information about complex tax issues such as:

- timing differences (for example, relating to perfectly legitimate things like differences between accounting and tax depreciation);
- the receipt of taxed foreign dividend income which is exempt in Australia, but which is included in total income;
- prior year losses incurred during the GFC being offset against taxable income but which are not reflected in total income or net profit for the current year;
- the receipt of franked dividends;

- differences between the tax and accounting characterisation of some financial instruments;
- permanent tax system design features such as R&D offsets; and
- concessionally taxed off-shore banking units;

In some cases this lack of contextual information could lead to companies having their reputations unfairly tarnished. Unfortunately, there are recent international examples where social justice groups have unfairly targeted large companies on the basis of their alleged poor tax performance when the facts do not support their position. There is a real risk that the same sorts of outcomes will occur in Australia under the proposed new rules.

Through its active compliance activities the ATO has access to a great deal of information about the tax performance of large companies. Over the years it has developed a deep understanding of most large businesses and it uses this knowledge to apply a risk based and mostly co-operative approach to its compliance work. It is not difficult to imagine a situation where a large corporate group is rightly regarded as being low risk by the ATO, but is nevertheless being targeted by activists as a tax avoider because of unfounded assumptions and misunderstandings arising from the publication of tax data under this proposal.

Such misunderstandings may in some cases be rectified where affected companies choose to voluntarily publish more detailed information, but there is no guarantee this will always preserve a company's reputation. A company wishing to explain its tax performance in a more meaningful way would most likely start with its audited pre-tax profits adjusted to get to the tax consolidated group position. They might then explain the main differences between net pre-tax profits and taxable income, and finally explain what rebates, credits or tax off-sets have been applied against the *prima facie* tax on their taxable income. Some companies may also choose to report on other taxes they pay, such as GST, payroll tax, excise and interest or royalty withholding taxes.

What are the benefits of this proposal?

In trying to judge the merits of the disclosure proposals we have sought to determine the outcomes the government is seeking to achieve. From what can be gleaned from various public statements made by Assistant Treasurer Bradbury, the drive towards greater transparency stems mainly from local and international concerns around base erosion and profit shifting (BEPS). And in spite of claims to the contrary[ii], the proposal does seem to include at least an element of "naming and shaming". The Assistant Treasurer's media release of 4 February 2013 said, in part:

> "Improving the transparency of Australia's business tax system will encourage enterprises to pay their fair share of tax and discourage aggressive tax minimisation practices."

In his foreword to the DP the Assistant Treasurer also sought to counter arguments against these proposals by questioning why anyone would argue against "describing what those taxpayers have been and are doing" or "opposing measures that would increase the transparency of the tax affairs of large and multinational enterprises."

BEPS is certainly a topical issue around the world, with both the OECD and the G20 being very active, while in Australia the government has convened the Specialist Reference Group (SRG) to advise Treasury about ways of addressing tax minimisation by multi-national enterprises (MNEs). The CTA supports this process and considers that further work is required to determine the nature and extent of any material threats to Australia's tax base posed by the sorts of practices that have been creating concerns. Australia needs to engage in global efforts to combat any BEPS problems that are identified, but we need to be part of a multilateral effort and take care to ensure that any steps taken do not have an adverse impact on own tax base.

It is far from clear in what way the current proposal will make any meaningful contribution to this process.

We have also heard that the government may believe that it needs to have a better understanding of how individual companies might be affected by tax policy decisions that might be under consideration from time to time. If so, we would have thought the opposite was actually true. From a governance perspective it would in our view be preferable for ministers to take a macro approach and focus on the broader corporate sector when making tax policy decisions. Individual interactions on tax matters have always been a matter for the ATO and in our view things should remain that way. Indeed, we regard it as regrettable that the Assistant Treasurer in recent speeches has sought to cast the tax performance of particular companies in an unfavourable light.

Will the proposed disclosure scheme successfully target suspected tax minimisers by exposing their nefarious activities?

While the notion of greater transparency has some intuitive appeal, we have serious reservations about the likely effectiveness of this proposal in achieving its apparent objectives.

Take, for example, an Australian-based MNE that shifts its tax base and profits to a low-tax jurisdiction by relocating intangibles there. The problem with the proposed disclosure regime is that the steps taken by this company will shift its commercial profits to the low-tax jurisdiction along with its taxable income. When the company's Australian tax performance is disclosed it is not likely to have a low effective tax rate, as the effective tax rate will itself reflect whatever BEPS activities the company has engaged in.

The right approach in relation to such a company would be for the ATO to apply the existing transfer pricing and general anti-avoidance rules, which incidentally are both in the final stages of being strengthened (in ways that many commentators believe is excessive and unwarranted).

Another example that has attracted some attention recently is that of a foreign-based company that sells advertising services to Australian residents through the internet. While it may be true that the existing international tax rules sometimes struggle with the tax treatment of e-commerce, the consensus among tax experts is that (depending on the facts) those sales would in most cases represent imports into Australia and any net income they generate is not Australia's to tax under the well recognised rules around residency and source. Where those companies do have a permanent presence in Australia they will be liable to tax here according to those same rules.

The CTA has no problems with the tax rules around e-commerce being reviewed on a multi-lateral basis, and this may well happen in the near future. But it would be a mistake to think that the proposed disclosure rules will flush out any of these non-resident entities. Indeed, we understand that when the ATO recently sought to obtain sales and other information from certain MNEs that make sales to Australian residents without having a permanent presence here, a number of those entities declined to provide the information requested[iii].

Public disclosures are not high on the OECD "to do" list

The OECD's recent report *Addressing Base Erosion and Profit Shifting* put forward a number of areas that countries can usefully address now to help address the BEPS problem. Those areas were:

- cross-border arbitrage on entity and instrument characterisation mismatches;
- the application of treaty concepts to profits derived from the delivery of digital goods and services;
- related party debt financing and captive insurance;
- transfer pricing generally and in relation to intangibles in particular;
- the effectiveness of general anti-avoidance rules, the attribution rules, the thin capitalisation rules and rules preventing treaty abuse; and
- harmful tax preferential regimes.

Publically reporting the tax performance of large companies was not even one of the top six areas the OECD thought member countries should focus on. If the government believes this is such a good idea it should take it to the OECD or the G20 and argue the case for having it implemented on a multi-lateral basis. That way we would at least end up with a reporting regime that is consistent across jurisdictions and which would facilitate the making of meaningful comparisons.

Rather than be a first (or second) mover, Australia should be cautious and be part of a multilateral approach

Rather than leading what could be a very small pack, Australia should adopt a wait and see approach on public disclosures, as it is doing in relation to the Extractive Industries Transparency Initiative. While the suggested disclosure policy may have some superficial popular appeal and any reputational damage caused by its adoption can probably be mitigated through voluntary additional disclosures in most cases, it is unlikely to promote an informed public discourse about the tax performance of large companies. Nor will it flush out foreign based MNEs that are not paying their “fair share” of tax in Australia. Enforcing our existing tax rules will.

Attached as an appendix are some issues of detail, which we consider should be addressed in the event that some sort of disclosure regime is imposed. That should not be taken as indicating that the CTA in any way supports this proposal. Public disclosure of confidential tax information in the manner put forward in the DP is a bad policy idea that does not stand up to any robust analysis and should not proceed.

Yours Sincerely,

(Frank Drenth)
Executive Director

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APPENDIX

- The $100 million turn-over threshold is very low and will impose significant compliance costs on smaller entities as they take steps to better explain their tax performance and pre-empt misunderstandings and confusion that will inevitably arise from the publication of the bare tax numbers as proposed in the DP. If the threshold is to be based on total income, it should in our view be raised to $1 billion.

- The position of companies with substituted accounting periods should be clarified. The DP states that the proposal will apply to "the 2013-14 and later income years". That would mean a 31 December early balancing company, whose year ending 31 December 2013 is in lieu of the 'normal' tax year ending 30 June 2014, is already subject to the new regime. For SAP companies the new rules should apply for their first year of income that commences after 1 July 2013, which for a December early balancer would be the year ending 31 December 2014.

- The treatment of related MEC groups needs to be clarified so that it is clear the ATO disclosure will cover the same entities as any voluntary disclosures made by the group. Trusts can be subsidiary members of consolidated groups, while this proposal only applies to companies. The preferred approach would probably be to regard the entire consolidated group, including trusts, as the relevant entity for disclosure purposes. Also, in making any additional voluntary disclosures, MEC groups will most likely eliminate related party transactions within the consolidated MEC group. It is not clear how this would align with the proposed statutory reporting by the Commissioner.

- In order to enable companies to make their voluntary disclosures at the right time, they will need to know in advance when the Commissioner proposes to publish the information about their tax affairs. This could be achieved by way of a statutory requirement for the information to be published by a certain date each year, by the Commissioner notifying affected companies, or by way of a public notification.

- To help avoid reporting errors and to assist companies wishing to publish additional information about their tax performance on a voluntary basis, the Commissioner should give companies some advance notice of the tax information it intends to publish about them.

- Where errors are made in publication, there will need to be a mechanism for taxpayers to have any erroneous information corrected by the ATO.

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- Consideration will have to be given to what happens about statutory disclosures when a particular assessment is amended in a material way. Is there going to be a supplementary disclosure in respect of that year or will it be taken up as a prior year adjustment in a later year?

- PRRT and MRRT are levied on a project bases. It is unclear whether rent taxes will be published on a project basis or whether taxpayers involved in more than one project will have those taxes aggregated for reporting purposes.

- It would be all too easy for lists or tables to be used to make inappropriate comparisons between very different corporate groups and to level unwarranted charges about their tax performance. The information should be searchable on an individual company basis, using the name or ABN. We understand this is what happens in Denmark.

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[i] DP, page 7
[ii] "Stateless income" speech at The Tax Institute National Convention 15 March 2013
[iii] NTLG meeting 22 March 2013