31 May 2013

Institute of Chartered Accountants Australia

Principal Adviser
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Dear Sir/Madam

Issues paper on *Implications of the Modern Global Economy for the Taxation of Multinational Enterprises*

The Institute of Chartered Accountants Australia (the **Institute**) welcomes the opportunity to make a submission on the issues paper entitled *Implications of the Modern Global Economy for the Taxation of Multinational Enterprises* (**Issues Paper**) released by the Assistant Treasurer, the Hon David Bradbury MP, on 3 May 2013.

The Institute is the professional body for Chartered Accountants in Australia and members operating throughout the world. Representing more than 70,000 current and future professionals and business leaders, the Institute has a pivotal role in upholding financial integrity in society. Members strive to uphold the profession's commitment to ethics and quality in everything they do, alongside an unwavering dedication to act in the public interest.

The Issues Paper seeks comment on the range of issues canvassed in the Issues Paper for the purposes of informing a Treasury Scoping Paper to be released in late June.

At the outset the Institute makes the following two key observations of principle which inform our subsequent comments:

- Australia is a relatively small open economy which is heavily dependent on cross-border flows of inward investment and outward supplies of goods, notably minerals, for its economic prosperity. As such, Australia's economic profile and interests may be different to those of other countries in the OECD, and indeed the world more broadly. It is therefore important that the proposals put forward in the Treasury Scoping Paper are framed by reference to Australia's relative economic position in the world and that of its main trading partners.

- Australia, in contrast to some other countries, benefits from strong tax collections deriving from an efficient tax administrator and robust tax laws. 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 and where this does occur the Australian Taxation Office (ATO) is already equipped with some of the strongest tax anti-avoidance rules in the world.

In respect to the three consultation questions posed in the Issues Paper we make the following comments.

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Consultation question 1

> *Views are sought on the extent to which another country not exercising its right to tax should be a matter of concern to Australia.*

The Institute understands that the level of awareness of, and concern with, what has been termed "base erosion profit shifting" (**BEPS**) varies around the globe. These levels appear to vary significantly in accordance with, and largely in correlation to, the economic circumstances and profile, including fiscal budgetary position, of particular countries and regions. For example, the debate is most acute in the UK which although it appears to have technically avoided a triple dip recession since the onset of the GFC remains mired in difficult economic circumstances. This contrasts starkly with the 21 years of uninterrupted economic growth enjoyed by Australia.

Accordingly, in the Institute's view Australia's engagement in the BEPS debate should be driven by regard for Australia's interests. These should be paramount rather than altruistic motives. It follows that the extent to which Australia should be concerned whether or not another country exercises its right to tax depends upon whether that exercise or omission negatively impacts on inward investment into Australia and the outward supplies of goods and services from Australia. This suggests a case by case approach, with a particular focus on the positions of our principal trading partners, rather than a broad-based statement of principle. That case-by-case approach should be informed by detailed analysis which takes into account the entirety of a particular country's relationship with Australia.

Consultation question 2

> *Views are sought on whether there is evidence of Base Erosion and Profit Shifting in Australia. Where it is considered that insufficient data exists to reach a definitive conclusion on the extent and nature of the problem in Australia, comments are sought on how to identify and/or develop such data — including the benefits and costs of requiring companies to provide more detailed information to the ATO.*

A noteworthy feature of the February 2013 report on *Addressing Base Erosion and Profit Shifting* (**OECD BEPS Report**) was the absence of empirical data as to the scale of the perceived BEPS problem. Indeed, the OECD BEPS Report highlighted that the "average of revenues deriving from taxes on corporate income as a percentage of GDP" had increased over time from 2.2% in 1965 to 3.8% in 2007.[1] This is despite a backdrop of decreasing corporate tax rates. The report did point to a decline in these percentages in 2008 and 2009, but noted a recovery in 2010 to 2.9%.[2] These short term changes would seem to be largely referable to the impact of the GFC on corporate profitability.

The OECD BEPS Report did, however, point to a possible indirect indicator, namely the amount of global investment made through specified countries with low taxation rates. For example, the OECD BEPS Report highlighted that in 2010 British Virgin Islands was the second largest direct investor in China.[3] However, the OECD BEPS Report qualified this, and similar observations, by noting in effect that the existence of investment through low or no tax jurisdictions "does not imply that they are being used for BEPS purposes". Accordingly, the inferential value of these statistics as an indicator of significant BEPS activity is low.

The Institute is unaware of any empirical data suggesting that BEPS is a significant problem to Australia's fiscal position, although it notes that comments have been made to that effect.

In the absence of empirical data the immediate questions become:

- which data needs to be collected to evidence the problem, or not?; and
- how best to collate that data?

[1] OECD BEPS Report, p. 16.
[2] *Ibid*.
[3] *Ibid*., p. 17.

In answering those questions regard should be had to the two key observations of principle made at the outset of the submission. Those principles evidence themselves in this context that any additional compliance cost be proportionate with the likely expected evidentiary value of the information obtained. In economic terms unnecessary compliance costs act as a dampener on economic activity by diverting scare resources to unproductive activities.
In this regard the Institute makes two observations:

- evidence of BEPS activity by definition involves a consideration of how a single economic transaction is taxed in two or more different jurisdictions. It follows that in order to establish evidence of BEPS it is necessary to source data from two or more jurisdictions. The Institute notes that the primary vehicle for obtaining data from overseas jurisdictions is Australia's bilateral Tax Information Exchange Agreements (TIEAs). The ATO is also a member of JITSIC; and

- the ATO already collects an enormous amount of data about Australian and multinational companies which provides the necessary raw data for trend identification if appropriate data analytic tools are developed to distil the information needed to draw inferences and to develop (say) industry benchmarks. This includes data gleaned from:

    - International Dealings Schedules (IDS) – the instructions to which runs to 80 plus pages;
    - Advance Pricing Agreements;
    - Reportable Tax Position schedules;
    - Pre-lodgement tax return reviews;
    - Annual compliance arrangements;
    - Private binding rulings; and
    - ATO risk identification materials including listings of tax haven subsidiaries etc.

The Institute recommends that given there are already existing data channels and sources that these be used more efficiently by the government to establish evidence as to the scale of BEPS in Australia. It would, for example, be quite inefficient and indeed wasteful of resources to build an entirely new mechanism of information collection for tax policy purposes in these circumstances. We note that the Tax Administration Act allows, we suggest, the ATO to inform policy makers appropriately. That said, we would be most concerned if the ATO were tasked with collecting additional information from taxpayers due to the detrimental economic impact arising from additional compliance costs.

Consultation Question 3

> *Views are sought on whether the key pressure areas identified by the OECD represent the main priorities for action in the short term. If so, what should be the shape of measures to address these pressure areas. If not, what areas should be the focus of action?*

The Issues Paper indicates that the OECD pressure areas are the following:

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;

5. Anti-avoidance measures (including addressing harmful tax practices).

As noted at the outset Australia has a strong tax compliance culture, an efficient tax administrator and robust tax laws. Moreover, the current government has recently introduced, or will shortly introduce, legislation which:

- changes the privacy laws relating to the disclosure by the ATO of specific taxpayer tax information held by it;
- tightens yet further Australia's already very strong general anti-avoidance rule (GAAR) together with a range of amendments to various specific anti-avoidance rules (SAARs);
- modernises the transfer pricing rules; and
- further restricts, or eliminates, the capacity to claim interest deductions on debt used to finance business activities performed outside Australia eg the announced changes to the thin capitalisation rules and abolition of section 25-90.

The Institute has, or will, comment of the policy merits and efficacy of these changes in separate submissions. While the Institute has a number of reservations as to the merits of these changes those concerns are not reproduced here. However, relevantly for the purposes of the Issues Paper the Institute suggests that the only pressure points highlighted by the OECD BEPS Report, which the Government might reasonably suggest require focus, are items 2 and 4. Our comments on these areas are made in reverse order.

Dealing with uncertainty on where production occurs in a digital economy, including the role of intangibles

The Institute considers that this issue requires a global consensus and Australia's interests are best served through active participation in global consultations bearing in mind Australia's specific economic profile and interests.

Indeed the OECD BEPS Report states that the action plan currently under development will include proposals to find:

> "Updated solutions to the issues related to jurisdiction to tax, in particular in the areas of digital goods and services. These solutions may include a revision of treaty provisions."[4]

The Institute considers that this is a separate issue which should not be confused with BEPS. There is no indication, or suggestion, that the digital economy companies are not operating in full compliance with domestic laws and OECD policy. The proper question is whether the existing international laws for allocating profits earned by these companies between countries for taxing are appropriate. It is an issue of the laws, not the businesses. If the two are confused public commentary runs the risk of demonising multinationals. As noted by Mr Angel Gurria the OECD Secretary-General:

> "It's not about bashing the multinationals, we want their investment, we want their job creation capacity, and we want their innovative capacity. The question is really to make sure that there is a better distribution of burden and at the same time that we assure the multinationals that they are not going to be multi-taxed." [5]

Tackling tax arbitrage opportunities from international mismatches in entity and instrument characterisation

The Institutes considers it premature to consider action to tackle "tax arbitrage opportunities" until there is a better understanding of whether the tax arbitrage opportunities create an integrity risk. However, the Institute agrees that multilateral agreement on the principles for the treatment of hybrid instruments and entities is a desirable long term project.

[4] OECD BEPS Report p.10.

[5] 23 May interview, Australia's ABC program "The Business":

For the purpose of developing the position in the Scoping Paper, the debate should recognise that differential treatments under the international tax system can be unavoidable and *prima facie* do not indicate abuse. Further, the Institute considers that a close examination of the anecdotal evidence may show that many cross border hybrid instruments do not result in any reduction in the worldwide tax rate.

The Institute considers that the Scoping Paper should canvass the following:

1. The debate concerning the treatment of cross border hybrid instruments should focus on the policy surrounding its treatment of cross border hybrids instruments. It would be unfortunate if the debate is influenced by either unproductive criticism of taxpayers for using hybrid instruments or criticism of the ATO for accepting the use of hybrids.

2. Recognise that debate should not be governed by perceptions that "base erosion" has recently increased by the use of hybrid arrangements. The law governing the in substance classification of instruments for tax purposes was introduced in 2002. It is unlikely that base erosion has been caused by an explosion of the widespread use of these instruments in just a few years.

3. The differential treatment of cross border hybrids can be to Australia's advantage or may meet the policy objectives of both countries.

   Conclusions on the preferred approach to the taxation treatment of cross border instruments at the OECD level are likely to persist as international tax policy in the long term. Australia's best interests lie in advocating that the OECD fully consider and debate the matter before any bilateral action is endorsed by the Australia.

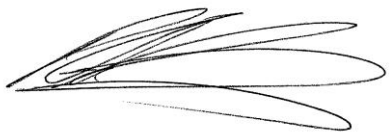
4. Australia's initial position in the debate at the OECD level should be that Australia will not agree to a position unless it is in the best interests of both the Australian economy, and that short term revenue gains are less important that long term benefits to the Australian economy.

5. Recognise that Double Tax Agreements (DTAs) already deal with tax arbitrage on hybrid instruments and entities and that this may be the preferred means for dealing with cross border issues.

   For example, in most of Australia's more recent DTA's the Interest and Dividend Articles interact so that the source country taxing rights on dividends will be governed by the Interest Article where the source country applies its tax laws to the dividend in the same way as it applies its tax law to interest. However, the DTA does then not compel the residence country to provide credit of underlying tax on the company paying the dividend. Thus, the DTA is internally consistent.

   Whether there is double non taxation is (in general) irrelevant to allocating taxing rights. Quite correctly, within these limitations, each country's may choose to tax the income as it sees fit in the best. If there is a change in policy on this matter, then the change should be implemented through bilateral agreement under the DTAs.

Yours sincerely



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