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Principal Adviser
Corporate and International Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

31 May 2013

Dear Sir/Madam,

Implications of the Modern Global Economy for the Taxation of Multinational Enterprises

Publish What You Pay (PWYP) Australia welcomes the opportunity to provide this submission to the Government's consultation on 'Implications of the Modern Global Economy for the Taxation of Multinational Enterprises', specifically 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'.

PWYP Australia is a coalition of 30 humanitarian, faith-based, environmental, anti-corruption, research and union organisations campaigning for greater transparency and accountability in the extractive industries that enjoy broad support across the Australian community. PWYP Australia works with the international PWYP network of over 700 civil society organisations to ensure that mining and oil and gas revenues are used for economic development and poverty reduction in resource-rich countries, including Australia.

The extent to which another country not exercising its right to tax should be a matter of concern to Australia

The taxation of multinational enterprises is not just a matter of concern for Australia and other OECD countries, it also a matter of concern for resource-rich developing countries. Many of which are dealing with what is known as the 'resource curse' where countries rich in oil, gas and minerals are often found to have lower economic growth, greater poverty and inequality and more conflict and instability than countries with fewer natural resources. Although multinational enterprises, including Australian entities, make profits from the exploitation of resources, host countries, and local communities in particular, can actually become poorer when large-scale projects take place on their lands especially if those companies avoid paying tax.

Tax avoidance in resource-rich countries should be of concern to a government that is investing heavily in its Mining for Development program which advocates resource extraction as a development pathway for resource-rich developing countries.

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If extractive companies operating in developing countries are able to avoid paying their fair share of tax it is impossible for those countries to receive the full financial benefits from mining or oil and gas activities. Instead the 'resource curse' and dependency on aid, as substitute for missing tax bases, from OECD countries, including Australia, are likely to be perpetuated.

We are advocating for the Government, as part of its response to this consultation, to introduce rules that require **extractive companies listed or based in Australia to disclose all payments made to governments on a country-by-country and project-by-project basis** in line with United States and forthcoming European Union legislation.

As outlined in the OECD's report, *Addressing Base Erosion and Profit Shifting*, transparency is an essential element if resource-rich developing country governments are to prevent profit shifting to extra-territorial low-tax jurisdictions and ensure that they receive the payments due for the extraction of their finite natural resources. It would help to tackle the kind of transfer pricing and tax avoidance a leaked Grant Thornton audit report accuses Glencore (now Glencore Xstrata) of in relation to its Mopani mine in Zambia which concerned the company selling copper to Switzerland at below market prices. The auditors also found the operational costs of the company increased exponentially, with little justification from 2005-7. The artificial inflation of costs, combined with undervaluing of the copper exports enabled the company to report overall losses, and therefore pay little or no corporation taxes in Zambia where two thirds of the population live on less than $1.25 a day. [1]

The African Development Bank and Global Financial Integrity's latest report, *Illicit Financial Flows and the Problem of Net Resource Transfers from Africa: 1980-2009*[2], finds that **Africa is a net creditor to the rest of the world of up to $1.4 trillion when recorded transactions like exports, imports, foreign aid and foreign direct investment are netted with unrecorded illicit financial outflows**. The largest losers of net resource transfers are all resource-rich countries: Nigeria, Libya, South Africa, Algeria and Angola. Given their abundance of natural wealth, one would expect these countries to be receiving net resource inflows due to large natural resource exports.

The Africa Progress Panel – which is chaired by former United Nations Secretary General, Kofi Annan and includes Michel Camdessus, former Managing Director of the International Monetary Fund, Peter Eigen, former Chair of the Extractive Industries Transparency Initiative and Robert Rubin, former Secretary of the United States Treasury – agree that transparency in the extractive industries is essential to ensure that resource-rich countries can harness their natural wealth for development. In its Africa Progress Report 2013, *Equity in Extractives: Stewarding Africa's natural resources for all*, the panel's first recommendation calls on Australia to act and bring in mandatory payment disclosure requirements for its extractive industry companies:

Adopt a global common standard for extractive transparency: All countries should embrace and enforce the project-by-project disclosure standards embodied in the US Dodd-Frank Act and comparable EU legislation, applying them to all extractive industry companies listed on their stock exchanges. It is vital that Australia, Canada and China, as major players in Africa, actively support the emerging global consensus on disclosure. It is time to go beyond the current patchwork of initiatives to a global common standard.[3]

Aside from helping tackle tax avoidance and empowering policymakers to ensure that the wealth generated by extractive industries is used to fund sustainable development in resource-rich

[1] www.letemps.ch/rw/Le_Temps/Quotidien/2011/02/09/Economie/ImagesWeb/Audit%20Glencore%20Mopani.pdf
[2] African Development Bank and Global Financial Integrity, *Illicit Financial Flows and the Problem of Net Resource Transfers from Africa: 1980-2009*, May 2013
[3] Africa Progress Panel, *Africa Progress Report 2013: Equity in Extractives: Stewarding Africa's natural resources for all*, May 2013

countries, increased transparency of payments made by extractive companies provides other important benefits. It mitigates risks of corruption and enables populations to hold their governments to account over the exploitation of non-renewable natural resources. It also enables investors to better assess the financial, political and reputational risks to which extractive companies are often exposed, while fostering more stable operating environments that enhance prospects for investment returns. Indeed, there is now the possibility that Australian extractive companies will lose out on investment to competitors on markets that are introducing transparency requirements.

In this period of intense competition for access to natural resources in Africa and elsewhere and as the tax affairs of multinational businesses come under ever greater scrutiny, transparency of payments to governments provides extractive companies with the means to demonstrate the economic contributions they make in the countries where they operate.

The emergence of a global transparency standard

On 9 April and 13 May, a global transparency standard for the extractive industries emerged when the European Union finalised negotiations to amend its Accounting and Transparency directives, respectively. The amendments will require EU-registered and EU-listed extractive companies to publish the payments they make to governments worldwide.[4] This legislation will be formally voted on by the European Parliament on 12 June. It follows the passing of a similar provision in the United States Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 which is now in force via implementing regulations issued last August.[5] Together, the US and EU laws will cover about 65 per cent of the value of the global extractives market, and over 3,000 companies, including most of the international oil and mining majors, as well as Chinese, Russian, Brazilian and other state-owned companies. **Companies listed in the US and EU that operate in Australia will be required to disclose payments they make to the Commonwealth, State and Territory governments.**

Norway has also committed to introduce from 1 January 2014, rules that will at least align with the EU requirements[6] and in Canada an industry-civil society working group is currently developing a framework for the disclosure of payments to governments by Canadian mining companies. The Canadian Government will make policy recommendations for the adoption of extractive industry disclosure requirements in June following the completion of this work.[7]

Extractive companies seeking to raise capital on the Hong Kong and London AIM stock exchanges are already mandated to disclose payments to governments as part of their initial listing requirements.

While PWYP Australia welcomes the Government's proposed reforms to improve the transparency of Australia's business tax system, **the interconnectedness of the world's economies and the ability of multinational extractive companies to use this to circumvent national tax jurisdictions mean multinational companies must be required to disclose multi-country payment information in order to help ensure that companies pay their fair share of taxes in the countries where they operate.**

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[4] Proposal for a Directive of the European Parliament and of the Council on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, 9 April 2013: www.eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52011PC0684:EN:NOT
See also Statement by European Commissioner Michel Barnier on 9 April 2013: www.europa.eu/rapid/press-release_MEMO-13-323_en.htm

[5] United States Dodd-Frank Bill Section 1504, 2010. For the SEC's final rules, adopted 22 August 2012, please visit: www.sec.gov/rules/final/2012/34-67717.pdf

[6] www.regjeringen.no/en/dep/ud/campaigns/dialog_forside/johnsen_llr.html?id=697043

[7] Canadian Government Response: Sixth Report of the Standing Committee on Foreign Affairs and International Development Recommendation 10: www.parl.gc.ca/HousePublications/Publication.aspx?DocId=6030574&Language=E&Mode=1&Parl=41&Ses=1

Mandatory reporting complements the EITI

The Government is currently undertaking a pilot of the Extractive Industry Transparency Initiative (EITI), a voluntary initiative which requires governments that sign up to it to publish what they receive from extractive companies and those companies to publish what they pay to governments. This process is overseen by a multi-stakeholder group of government, industry and civil society representatives.

It was the US and EU legislators' intention for their disclosure rules to complement and strengthen the EITI by codifying its best practices.[8] Payment disclosure requirements will lead to the generation of timely, disaggregated and easily comparable data and will apply to those countries that remain outside the voluntary system. This will not only help raise the bar for EITI reports but will also provide multi-stakeholder groups with a higher level of data to inform their discussions. As the EITI Chair, Clare Short, has stated "The EITI is not only about publishing the numbers: countries implementing the EITI have a platform for dialogue about all aspects of the use of their country's natural resources. The EITI multi-stakeholder groups will, if anything, be more important following listings requirements."[9]

The United States, British and French governments have acknowledged the complementary relationship between the two mechanisms by committing to implement the EITI in addition to introducing legislation.

Compliance costs

In terms of compliance costs, companies already collect and track the data that would need to be disclosed. They keep books and records for themselves and their subsidiaries under existing securities laws, to comply with national anti-bribery statutes and for their internal accounts.

Extractive companies also keep records of project-level payment data. Australian listed companies that operate in the US already report on a lease level to the US Department of Interior, others publicly report payment information by lease/license voluntarily or do so as required by the World Bank, the new EITI rules or other national law. Australian listed companies cross-listed in the US and/or the EU, including BHP Billiton and Rio Tinto, will be required to report at project level from October 2013 in the US and within the next two years in the EU.

Estimates of the cost of project-level reporting, in the low millions of dollars, are put in perspective by the record profits enjoyed by the large mining companies: for the last financial year BHP Billiton and Rio Tinto made profits of USD 15.4 billion and USD 5.8 billion respectively.

The European Commission has estimated the cost of project-level reporting for 171 companies to be 0.05% of annual revenues in the first year and less thereafter.

In its final rules for the US legislation, the Securities and Exchange Commission, using Barrick Gold's estimate of time required to comply with the legislation and its own estimate of USD 400 per hour costs, stated the following:

Barrick Gold estimated that it would require 500 hours for initial changes to internal books and records and processes, and 500 hours for ongoing compliance costs. At an hourly rate of $400, this

[8] See United States Dodd-Frank Bill Section 1504, 2010 and Proposal for a Directive of the European Parliament and of the Council on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings.
[9] www.eiti.org/blog/false-dilemma-complementarity-new-disclosure-requirements-and-eiti

amounts to $400,000 (1,000 hours x $400) for hourly compliance costs. Barrick Gold also estimated that it would cost $100,000 for initial IT/consulting and travel costs for a total initial compliance cost of $500,000. As a measure of size, Barrick Gold's total assets as of the end of fiscal year 2009 were approximately $25 billion. As a percentage of Barrick Gold's total assets, initial compliance costs are estimated to be 0.002% ($500,000/$25,075,000,000).[10]

Implications for investment in Australian companies

As noted above, with around 65 per cent of the global extractive market covered by country and project level payment disclosure requirements, including companies that represent just under $300 billion in market capitalisation on the Australian Securities Exchange, there is in fact the risk in the near term, as data from these requirements begin to flow, that Australian issuers will attract less investment if they do not disclose comparable data.[11]

Payment disclosure is required in all major extractive markets in order to level the playing field and to protect those companies that act within the law from unfair competition and potential accusations of corruption that could lead to reputational damage. Such reporting must include project level disclosure, which is vital to identify and prevent corruption as well as tax avoidance and to help ensure that revenues benefit communities impacted by resource extraction activities.

The Financial Services Council, which represents over 130 members that invest $2 trillion per year, and the Australian Council of Superannuation Investors, which represents members with more than $350 billion in funds under management, support such disclosure in Australia as it will enable their members to compare and evaluate Australian companies, using the same type and level of information, with those listed on competing global markets. [12]

Recommendations

Recommendation 1: PWYP Australia recommends that the Government acknowledges the complementary relationship between mandatory disclosure requirements for extractive companies, which is international in scope, and conducting an EITI pilot, which is domestic in scope, and considers the introduction of payment disclosure legislation prior to the conclusion of the pilot.

Recommendation 2: PWYP Australia recommends that the Government introduces requirements – that aligns with US and EU legislation – that mandates the disclosure by extractive companies, listed or based in Australia, of payments[13] to governments on a country-by-country and a project-by-project basis. [14]

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[10] Page 184: www.sec.gov/rules/final/2012/34-67717.pdf. The SEC notes that the figure of USD 400 'is the rate we use to estimate outside professional costs for purposes of the PRA. Although we believe actual internal costs may be less in many instances, we are using this rate to arrive at a conservative estimate of hourly compliance costs.'

[11] PWYP Australia, Australia: *An Unlevel Playing Field - Extractive industry transparency on the ASX 200*, May 2013

[12] ACSI submission to the ASX consultation on Reserves and Resources Disclosure Rules for Mining and Oil & Gas Companies, 27 January 2012:
www.acsi.org.au/images/stories/subs_pres__speeches/12%20Submission%20to%20ASX%20Listing%20Rules%20Review%20Paper.pdf
FSC letter to the ASX, 29 September 2011:
www.fsc.org.au/downloads/file/SubmissionsFile/2011_0928_LettertoAustSecuritiesExchangereAustralianImplementationofExtractiveIndustriesTransparencyInititive.pdf

[13] In addition to tax payments, all other significant payments to governments such as royalties, signature bonuses and license fees should be included.

[14] Under the US rules, extractive companies are required to report any payment or series of payments that equal or exceed USD 100,000 in a fiscal year. In the EU the threshold is EUR 100,000.

As a major mining nation, a recent signatory to the Open Government Partnership and as the next chair of the G20, Australia has an important opportunity to show leadership in the region by adopting a country-by-country and project-by-project reporting requirement for extractive companies. We strongly encourage the Government to recognise the global momentum and give these recommendations its upmost consideration.

Yours faithfully,

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