Uniting Church in Australia
SYNOD OF VICTORIA AND TASMANIA

Justice and International Mission Unit
130 Little Collins Street
Melbourne Victoria 3000
Telephone: (03) 9251 5271
Facsimile: (03) 9251 5241
jim@victas.uca.org.au

The Manager
International Tax Integrity Unit
The Treasury
Langton Crescent
Parkes, ACT, 2600
transferpricing@treasury.gov.au

Justice and International Mission Unit
Synod of Victoria and Tasmania, Uniting Church in Australia

Submission to
Exposure Draft Tax Laws Amendment (2012 Measures No. 3) Bill 2012: Cross-border transfer pricing

April 2012

The Justice and International Mission Unit, Synod of Victoria and Tasmania, Uniting Church in Australia (the Unit) welcomes this opportunity to make a submission to the *Tax Laws Amendment (2012 Measures No. 3) Bill 2012: Cross-border transfer pricing* exposure draft.

The Uniting Church's position on Taxation

The Uniting Church in Australia, Synod of Victoria and Tasmania, is deeply concerned with ensuring tax justice. In 1997 the annual meeting of the Synod of Victoria passed a resolution:

(a) To affirm the principle that the payment of taxes is a moral responsibility that goes with citizenship;

(b) While acknowledging that taxation reform is a complex issue, to recommend to the Federal Government that the following guidelines need to undergird any reform of the Australian Taxation System:

- *(i) that the taxation system be primarily progressive and just;*
- *(ii) that the taxation system encourage a responsible use of our resources and stewardship of the environment;*
- *(iii) that the taxation system be designed in such a way as to lessen the gap between the rich and the poor;*

(c) To urge the Federal Government to incorporate within the Tax Reform agenda a resolution of Commonwealth-State taxation issues in such a way as to minimise State Government dependency on gambling taxes; and

(d) To inform the Federal and State Government of this resolution.

In 2008 the annual meeting passed a resolution:

to become a member of the Tax Justice Network and support its aims to:

- *(a) promote sustainable finance for development;*
- *(b) promote international co-operation on tax regulation and tax related crimes;*
- *(c) oppose tax havens;*
- *(d) promote progressive and equitable taxation;*
- *(e) promote corporate responsibility and accountability; and*

(f) promote tax compliance and a culture of responsibility

The Synod of Victoria and Tasmania has seen taxation as playing a vital role in ensuring a just society and a just world. The money lost by developing countries from transfer mispricing is vast. Anti-corruption non-government organisation, Global Financial Integrity, estimated collectively developing countries lost US$418 billion from transfer mispricing in 2009, much of this money laundered through secrecy jurisdictions. Africa lost US$25 billion in transfer mispricing, while the Philippines lost US$8.1 billion, Cambodia US$721 million and Indonesia US$8.5 billion.[1] Globally overseas aid in 2009 was only US$120 billion.

In 2009, Christian Aid commissioned international transfer pricing expert, Associate Professor Simon Pak, president of the Trade Research Institute and an academic at Penn State University in the US, to analyse EU and US trade data and estimate the amount of capital shifted from non-EU countries into the EU and the US through bilateral transfer mispricing. Professor Pak, who has advised US Congress on this issue, analysed bilateral trade in every product between 2005 and 2007, calculated the parameters of the normal price range for products traded between countries, and estimated the amount of capital shifted by trades that are outside that normal price range. He calculated the flow of capital from non-EU countries to the EU and US through transfer mispricing over that period was in the order of US$1.1 trillion, resulting in lost tax revenues to non-EU governments of US$365 billion.

The Christian Aid commissioned calculations also found that Australia lost 1.1 billion euros in tax revenue through transfer mispricing to the EU in the period 2005 – 2007 and US$1.5 billion in tax revenue through transfer mispricing to the US in the same period.[2]

The Unit notes with concern the significant growth in relation to intra-firm trade with regards to interest and insurance, and service components, both of which have more than doubled over the period 2002 – 2009.[3] It is these areas in which the OECD ‘arm's length' pricing principles are most open to failing to deal with tax evasion. The ATO Compliance Plan for 2010-11 notes this concern.[4]

The Unit supports efforts by the Australian Government, including the ATO, to limit tax evasion through transfer mispricing. The Unit agrees tax on corporations should be based on their economic contribution in Australia: through functions performed in Australia, the assets used or contributed by Australian entities, and the risks assumed on the Australian side. While the Unit agrees that as far as practicable trade pricing rules should be aligned with and interpreted consistently with international transfer pricing standards, it believes the Australian Government should advocate for those transfer pricing standards to be effective in stemming tax evasion through trade mispricing.

The Unit is concerned by allegations of well known multinational companies being engaged in tax dodging, suggesting that it cannot be taken for granted that all companies will seek to comply with the spirit of the tax laws in the countries they operate in. For example, the Bureau of Investigative Journalism has aired footage of a meeting with Vodafone's Swiss branch manager in which they allege he admitted Vodafone takes up takes up less than 5% of his time and that Vodafone has a dedicated room in his office but it is almost always

[1] Dev Kar and Sarah Freitas, ‘Illicit Financial Flows from Developing Countries Over the Decade Ending 2009', Global Financial Integrity, December 2011, pp. 5, 48-50.
[2] David McNair and Andrew Hogg, ‘False profits: robbing the poor to keep the rich tax-free', Christian Aid, March 2009. pp.20, 27.
[3] The Treasury, ‘Income tax: cross border profit allocation. Review of transfer pricing rules', Consultation Paper, 1 November 2011, p. 2.
[4] Ibid. p.3.

unoccupied. One of Vodafone's subsidiaries with profits worth US$2.5 billion is alleged to have been taxed at less than 1% in 2011. It was further alleged Vodafone did not respond to questions of how it allocates its profits between Switzerland and Luxembourg and why it maintains a Swiss bookkeeping office when it has so few business activities there.[5]

Media reports also indicate Google is under investigation by the US Internal Revenue Service and French tax authorities.[6] It is alleged to have avoided paying more than US$4.6 billion in tax in Britain and other countries over the last five years.[7] It is further alleged to have an elaborate network of companies spanning at least five countries, including Ireland, the Netherlands and Bermuda, that allow it to minimise its tax bill. Profits are legally shifted between Google subsidiaries that ultimately lead to Bermuda. It is claimed Google's tax rate on overall foreign earnings worked out at just 3%.[8] Despite handling billions in revenue, Google Ireland Ltd's accounts for 2009 show a profit of £41 million and a tax bill of £15 million. It paid more than £3.7 billion in royalties back to Google Ireland Holdings via an Amsterdam subsidiary.[9] It is further alleged Google cut its tax bill by about US$1 billion a year using a technique that allocates profits to a unit managed out of a law firm in Bermuda. In 2009, this subsidiary collected around US$6.1 billion in royalties from a Google unit in the Netherlands, according to a Dutch corporate filing.[10]

It is alleged Apple paid just £10.3 million in taxes for its three main British subsidiaries despite making an estimated £6 billion worth of sales in Britain.[11] It is alleged to have avoided paying higher taxes by using foreign subsidiaries, such as those in Ireland and the British Virgin Islands.

Amazon is reported to be under investigation by UK tax authorities after paying no corporation tax on any of its profits from the sale of more than £3.3 billion in the UK in the last year.[12] Regulatory filings by parent company Amazon.com with the US Securities and Exchange Commission show the tax inquiry into the UK operation focuses on a period when ownership of the British business was transferred to a Luxembourg company. Amazon's tax affairs are also reported to be under investigation in the US, China, Germany, France, Japan and Luxembourg. The latest 2010 accounts for Amazon EU Sarl show the Luxembourg office employed 134 people, but generated turnover of €7.5 billion. In the same year, the UK operation employed 2,265 people and reported a turnover of £147 million. Amazon is currently disputing a tax bill of nearly £1 billion imposed by US authorities related to transfer pricing.

The Unit accepts the OECD Guidelines constitute the transfer pricing standards of many of Australia's major investment partners and therefore applying them to revised laws makes sense at this time. Thus, the Unit supports the intension of the *Tax Laws Amendment (2012 Measures No. 3) Bill 2012* to ensure the domestic law that references the tax treaty transfer pricing rules are applied in a manner consistent with relevant OECD guidance.

The Unit supports the amendments contained within the Bill to ensure that the specific transfer pricing related articles as incorporated into Australia's domestic law provide

---

[5] Melaine Newman, 'Vodafone: Undercover investigation exposes Swiss branches', Bureau of Investigative Journalism, 6 March 2012.
[6] Jesse Drucker, 'IRS Auditing How Google Shifted Profits', Bloomberg, http://www.bloomberg.com, 13 October 2011.
[7] Dipesh Gadher, 'Light-footed Google in $4.6bn tax dodge', The Australian, 30 May 2011.
[8] Ibid.
[9] Ibid.
[10] Jesse Drucker, 'IRS Auditing How Google Shifted Profits', Bloomberg, http://www.bloomberg.com, 13 October 2011.
[11] Lousia Peacock, 'Taxman wants slice of Apple', The Age, 10 April 2012.
[12] Ian Griffiths, 'Amazon: £7bn sales, no UK corporation tax', The Guardian, 4 April 2012.

alternative and independent transfer pricing liability provisions to those contained in Division 13 of the *Income Tax Assessment Act 1936.*

The Unit supports the provisions of Subdivision 815-A to:

- ensure that the transfer pricing articles contained in Australia's tax treaties are able to be applied and operate to provide assessment authority independent of Division 13 through explicit incorporation into the *Income Tax Assessment Act 1997*; and
- require the arm's length principle to be interpreted as consistently as possible with relevant OECD guidance.

The Unit supports the aim of Subdivision 815-22(1)(a) to ensure an entity's tax liability in Australia reflects the profits that the entity would have made if it was an independent entity dealing with other entities on a wholly independent basis. It also supports that, for an Australian permanent establishment of a foreign entity, the amount of the transfer pricing benefit should be the profits that are attributed to the permanent establishment which fall short of the amount of profits that the permanent establishment might be expected to make if it were a distinct and separate entity. While the amount determined should have regard to the relevant circumstances of the permanent establishment, it should produce an arm's length outcome in the context of the relevant tax treaty article to the extent that is possible.

The Unit supports the inclusion of 815-22 (5) to clarify the rate of return for debt interest.

Beyond the *Tax Laws Amendment (2012 Measures No 3) Bill 2012*

While supporting the efforts to combat tax avoidance through the measures introduced in the *Tax Laws Amendment (2012 Measures No.3) Bill 2012*, the Unit remains concerned about the limitations of the 'arm's length' principle and continues to urge supporting other methods at a multilateral level to combat tax evasion through transfer mispricing. There is great scope for misunderstanding or deliberate mispricing in areas around intellectual property such as patents, trademarks and other proprietary information within the arm's length principle. Multinational enterprises arise in large part due to organisational and internalisation advantages relative to the efforts of unrelated, separate companies that seek to do business with one another. Such advantages mean that within multinational enterprises, profit is generated in part by internalising transactions within the firm. Thus, for companies that are truly integrated across borders, holding related entities within the commonly controlled group to an 'arm's length' standard for pricing of intracompany transactions does not make sense, nor does allocating income and expenses on a country-by-country basis.[13] Reuvan Avi-Yonah (2009) argues the arm's length transfer pricing rules have spawned a huge industry of lawyers, accountants and economists whose professional role is to assist multinational companies in their transfer pricing planning and compliance. He concludes that no matter how assiduously one performs "functional analyses" designed to identify "uncontrolled comparables" that are reasonably similar to members of multinational groups, one is rarely going to find them. He argues such comparables have not been found with sufficient regularity to serve as the basis for a workable transfer pricing system.

The Unit continues to believe the Australian Government should support the development of a new international norm to eventually replace the OECD arm's length principle using combined reporting, with formulary apportionment and Unitary Taxation.[14] This would prioritise the economic substance of a multinational and its transactions, instead of prioritising the legal form in which a multinational organises itself and its transactions.

---

[13] Reuven S. Avi-Yonah, 'Between Formulary Apportionment and the OECD Guidelines: A Proposal for Reconciliation', University of Michigan Law School, Paper 102, 2009.

[14] Tax Justice Network, 'Transfer Pricing', http://www.taxjustice.net/cms/front_content.php?idcat=139; and The Hamilton Project, 'Reforming Corporate Taxation in a Global Economy: A Proposal to Adopt Formulary Apportionment', The Brookings Institute, Policy Brief No. 2007-08, June 2007.

Unitary taxation originated in the US over a century ago, as a response to the difficulties US states were having in taxing railroads. Over 20 states inside the US, notably California, have set up a system where they treat a corporate group as a unit, then the corporate group's income is "apportioned" out to the different states according to an agreed formula. Then each state can apply its own state income tax rate to whatever portion of the overall unit's income was apportioned to it. Such a formula allocates profits to a jurisdiction based upon real factors such as total third-party sales; total employment (either calculated by headcount or by salaries) and the value of physical assets actually located in each territory where the multinational operates. The Unit recognises there are technical and political complexities involved in designing such an "apportionment" formula. However, limited forms of unitary taxation have been shown to work well in practice.

The aim of unitary taxation is to tax portions of a multinational company's income without reference to how that enterprise is organised internally. Multinational companies would have far less need to set themselves up as highly complex, tax-driven multi-jurisdictional structures and are likely to simplify their corporate structures, creating efficiencies. The big losers are those consultants who derive substantial income from setting up and servicing complex tax-driven corporate structures.

Hybrid versions of the arm's length and unitary taxation system are possible as interim steps.[15]

Dr Mark Zirnsak
Director
Justice and International Mission Unit
Synod of Victoria and Tasmania
Uniting Church in Australia
Phone: (03) 9251 5265
E-mail: mark.zirnsak@victas.uca.org.au

[15] Reuven S. Avi-Yonah, 'Between Formulary Apportionment and the OECD Guidelines: A Proposal for Reconciliation', University of Michigan Law School, Paper 102, 2009.