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Multinational tax integrity and enhanced tax transparency – PSI/ ITUC submission to public consultation

2 September 2022

Overview

The Australian government published on 5 August 2022 a consultation paper on the implementation of three proposals seeking to increase multinational tax integrity and tax transparency: a modification of existing thin capitalization rules, a new rule to limit certain types of tax deductions, and public country-by-country reporting. These proposals have the potential to have an impact on workers in Australia and worldwide. The proposals will also have an impact on the ability of governments to fund quality public services. Consequently, Public Services International and the International Trade Union Confederation make the following submission.

Public Services International (hereafter PSI) is a Global Union Federation that represents public service workers from more than 700 trade unions representing 30 million workers in 154 countries. We are dedicated to promoting quality public services in every part of the world. Our members, two-thirds of whom are women, work in social services, health care, municipal and community services, central government, and public utilities such as water and electricity. PSI represents public sector and private sector workers who work in public services. Decisions around tax systems, in Australia and around the world, are central to our members interests as it raises the revenue required to fund quality public services.

The International Trade Union Confederation (hereafter ITUC) represents 200 million workers in 163 countries and territories and has 332 national affiliates.

In recent years there has been a heightened public awareness that many multinationals do not pay a fair share of tax. This not only robs communities of the public services they need to thrive, but it also erodes trust in taxations systems and the institutions which govern them.

This submission calls for mandatory public country-by-country reporting, on the basis of the GRI tax standard with a wide scope of application. If necessary, a phasing-in period could be envisaged for medium-sized multinationals. This is a strong labour demand with positive effects on revenue collection, democracy and employment. Whilst there seems to be some increasing willingness across jurisdictions towards improved corporate tax reporting, transparency levels are not yet sufficient for unions and citizens to exercise appropriate scrutiny. With this legislative proposal, Australia is in a unique position to set a strong precedent globally towards more corporate accountability on their tax planning.

PSI and ITUC agree to the publication of this submission.

Introduction

Corporate tax avoidance and the opacity surrounding MNE tax planning directly affect workers and their unions. Aggressive tax planning harms employment in at least three ways.

First, expanded fiscal space is of the utmost priority to the labour movement. In a context of post pandemic bottlenecks, prospects of low economic growth and negligible employment generation, growing debt at sovereign, corporate and household level, energy crisis and increased cost of living, workers and their communities are deeply concerned about possible resurgence of austerity measures, that may lead to the worst case scenario of stagflation: recession with high inflation.

More and more progressive tax revenues are needed. Corporate tax avoidance costs some $500bn-$600 bn globally in lost progressive tax revenues. This seriously undermines the ability of states to fund health services, social protections and general public services to keep people safe and also to keep the economy running.

Second, aggressive tax planning stands in the way of a fair share of corporate profits. Profits are extracted from workplaces and sent to tax havens where they are not available for wage bargaining, productive investment and job creation.

Third, complex company group structures obscure employment liabilities. The artificial structures used to minimise corporate income taxes are the same ones that are used to circumvent labour law obligations. For instance, letterbox companies are a frequent vehicle for social fraud in Europe. Overall, when management is hidden behind several layers of artificial corporations, workers and their unions find it difficult to effectively exercise social dialogue.

The labour movement is actively engaging with policy-makers, calling for stronger regulations to tackle corporate tax avoidance. **We pursue in particular the following three priorities:**

- **Enhanced tax transparency;**
- **A 25% global minimum tax rate;**
- **Unitary taxation, on the basis of fair apportionment factors – including employment, assets and sales.**

Part 3 of the Australian Treasury consultation relates to that first priority. This PSI/ ITUC submission focuses on this part of the consultation, as the proposed legislation offers immediate prospects of impactful change.

Parts 1 and 2 of this consultation seek public input on the introduction of new limitations on the deductions that a multinational enterprise can claim for transactions with related parties. We acknowledge that such solutions, provided that they are ambitious in scope, can provide quick fixes at a time when revenue raising is much needed. In the short term, we see value in excluding interest on related-party loans as deductable items. Similarly, as an interim measure, we see value in denying deductions for payments relating to intangibles and royalties in jurisdictions where the effective corporate tax rate is below 25%.

Current challenges, however, result from the weaknesses of transfer pricing rules which treat subsidiaries and establishment of a same multinational as if they were autonomous entities. Looking ahead, we strongly encourage the Australian government to explore longer-term solutions away from transfer pricing rules towards unitary taxation and formulary apportionment. Only then would we treat multinational enterprises for what they are: global entities with a coherent business and tax strategy throughout the firm. A switch to unitary taxation is particularly important in the light of the digitalization of the economy. As highlighted by the recent OECD BEPS 2.0 process, and as the Australian consultation document rightly recalls, digitalized businesses can easily shift around unique and highly valuable intangibles without much constraint from the arm’s length principle.

Specific comments on Part 3: Multinational tax transparency

Question 1: Are there any specific features you would introduce to improve how MNEs publicly report tax information?

The reported data needs to be understood by the greatest number of workers, even those who are not tax experts. **Companies should report in a simple and standardised format, which will also reduce the room for accounting manipulation.** The requirement to carry public country-by-country reporting should apply to every corporation with an international presence and a significant workforce. Trade unions and civil society organisations around the world have issued numerous submissions to that effect.[1] Any reporting should be machine readable to facilitate stakeholder use.

Increased public scrutiny and the fear of reputational damage can go a long way towards curbing tax avoidance. For instance, a 2018 study found that as a result of mandatory enhanced tax transparency large EU banks with significant activities in tax havens substantially increased their tax expenditures[2].

For labour, accessible tax information is an indispensable element of corporate accountability. It allows workers to obtain a clearer, shared view of corporate profitability and labour productivity. This is essential for robust collective bargaining to share the benefits of corporate profits that reflect the underlying reality, rather than the values in accounts reported after profit shifting has occurred.

Citizen focused democracy is undermined while the means by which individual companies shift profits continue to be obscured. Citizens deserve to receive sufficient information on corporate tax strategies with a view to knowingly engage in policy discussions. Beside, public anger at rising inequality and underfunded public services will continue to drive reactionary political developments. We note that now investors are also demanding increased tax transparency[3].

Overall, there is a crucial need for more, better educated, better paid and empowered tax inspectors, able to do more "tax intelligence" to reduce tax abuse.

Question 2: How should large MNEs be defined for the purpose of enhanced public reporting of tax information? Would the Significant Global Entity definition be appropriate to use?

Considering the importance of public CBCR for stakeholders, a A$ 1 billion turnover threshold is too high. We understand that such threshold originates in the Action 13 of the BEPS Action Plan, which requires large MNEs to report on a country by country basis to tax administrations only. A frequent argument in favour of such high turnover is that whilst a few MNEs are covered, 90% of global corporate revenues are within the scope. However, aside from the perspectives of tax administrations, there are wider societal interests at stake. In particular, workers need to have access to key information on the structure, activities and profits of their company. Furthermore, there is the issue of a level playing field, because tax avoidance by MNEs continues to disadvantage companies that operate only domestically.

For this reason, the applicable thresholds for public CBCR should be lowered so that a greater number of MNEs are required to report annually. Inspiration could be found in the EU annual accounts Directive, which

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[1] See for instance these recent submissions: PSI , European Public Service Union, European Trade Union Confederation, Trade Union Advisory Committee to the OECD, BEPS Monitoring Group, Tax Justice Network

[2] Overesch, Wolff (July 2018), *Financial Transparency to the Rescue: Effects of Country-by-Country Reporting in the EU Banking Sector on Tax Avoidance*

[3] Bertossa (April 2019), *Why Even Investment Funds Want more Corporate Tax Transparency*, Premium Times 10.04.2019

Gary (August 2022*), Investors Fly Blind Without Public Country-by-Country Reports*, Bloomberg Tax 30.08.2022

set annual reporting requirements for MNE groups. That instrument defines medium sized companies as those with an annual turnover of EUR 40 million and 250 employees[4].

Question 3: Would you support an incremental (phased in) approach to mandatory tax transparency reporting for a broader range of entities, starting with large MNEs?

All multinationals that are currently required to report under Action 13 of the BEPS Action Plan should be required to begin public reporting at the earliest opportunity. As these large entities are already reporting to tax administrations, it can be safely assumed that they could publish some of that information without much additional cost.

For MNEs that are not currently covered by Action 13, a phase-in approach could be envisaged with a view to leave them sufficient time to adjust their technical set up.

Questions 4-5. Should Australia mandate improved tax transparency regime in line with the EU's approach to public CbC reporting? If so, why?

If the EU CbC approach was mandated in Australia, are there additional tax disclosures that MNEs should be required to report, such as related party expenses, intangible assets, deferred tax and effective tax rate (ETR) per jurisdiction?

As profit shifting is global, it is crucial for the Australian government to ensure that mandatory public CBCR has a wide scope of application – leaving no country behind. For this reason, PSI and ITUC do not recommend following the EU example.

At the time of the adoption of the EU final compromise on public CBCR, the European labour movement expressed strong disappointment, mostly because of its restrictive geographical scope[5]. Under the agreement, MNEs have to report their activities only for EU Member States and countries listed on the EU list of tax havens. The EU list of tax havens, however, is the outcome of a highly political process where countries are selected on the basis political and economic considerations. Many low tax jurisdictions do not appear on that list.

In terms of topics, the EU requirements touch upon right themes. However, as exposed below PSI and ITUC regard the GRI tax standard as the best reference in the field because it secures the right data, with more complete tax disclosure topics than the EU framework, and in a way that can be easily processed by stakeholders.

Question 6. Should the GRI tax standard be used as a basis for Australia to mandate MNE public CbC reporting? If so, why?

What sorts of entities (based on revenue or entity structure) should this mandate apply to?

Please provide details of any compliance costs associated with adopting the GRI tax standard approach to public CbC reporting.

We strongly recommend using the GRI tax standard as the required template for all reporting. The GRI standard is the outcome of a multi-year inclusive process involving a technical committee made up experts, including accountants, major investors, civil society, labour and reporting companies; and various rounds of public and private consultation. It is therefore **adjusted to respond to the expectations of companies and stakeholders alike.**

[4] Art 3 of EU Directive 2006/43/EC

[5] ETUC (2 June 2021), *EU deal on country-by-country reporting won't stop worst corporate tax practices*; EPSU (2 June 2021), *EP and Council agree incomplete public country-by-country reporting, leaving out major tax havens: why EPSU cannot welcome a flawed jewel*

In particular, the GRI standard ensures reconciliation with global group accounts, deals with intra-group transactions on a consistent basis, and requires entity-level reporting for any 'stateless' entities. Importantly, GRI standard gives MNEs the opportunity to report on their tax strategy, how they engage with tax authorities, policy-makers and external stakeholders. Furthermore, the GRI template provide disaggregate information that has the advantage of simplicity and can in principle be understood by the public.

In terms of entities covered, **the scope of public CBCR should be large and flexible in order to capture as many risks as possible**. Entities that conduct business in other jurisdictions through establishments and/ or subsidiaries should be covered. The scope should also be extended to company groups that are under the control of an individual so as to ensure that private investment funds are captured. Some private equity funds are famous for their short-term strategy, cutting costs on tax bills and employment. It is particularly relevant for workers to be made aware of such beneficial ownership, as this can have an impact on business strategy and potential conflicts of interest. The definition of control should be as flexible as possible so as to cover every case of an individual or individuals exercising a dominant influence.

The labour movement is strongly in favour of low turnover thresholds. For the reasons explained in the above introduction, aggressive tax planning has an adverse impact not only on tax revenues, but also create risks for employment and investment. **The EU Directive on annual financial statements is an interesting precedent. The threshold for medium sized groups is set at EUR40 million turnover and 250 average number of employees.**

The disclosure topics of the GRI standard are close to the Action 13 template. Thus, MNEs already reporting under Action 13 can be mandated to provide public information in line with the GRI standard at limited additional cost. For MNEs with a turnover below EUR 750 mn, a phasing-in period could help companies during an initial adjustment period under the understanding that over time all MNEs will publicly report. PSI and ITUC firmly believe that democracy, more efficient revenue collection and investor transparency outweigh the marginal, and likely one off, compliance costs or privacy concerns of private corporate interests.

Question 7. If the GRI standard was used as a basis for mandating CbC reporting in Australia, are there additional tax disclosures that MNEs should be required to report, such as related party expenses, intangible assets, deferred tax and effective tax rate (ETR) per jurisdiction?

PSI and ITUC recommend limited additional disclosures on employment, including where management is effectively held, total wages by jurisdiction and the extent of labour subcontracting. Furthermore, the upcoming global minimum tax agreed under Pillar 2 of the recent G20/ OECDE agreement will require MNEs to report on their effective tax rate at jurisdictional level. A requirement to report on effective tax rates, therefore, will not require significant additional burden and should be included to the GRI template. Finally, related party expenses and intangible assets could be reported in more details. The latter is particularly relevant in context of the digitalisation of the economy, where companies are able to extract considerable profits out of unique and highly valuable intangibles.

Questions 8 and 9. Would legislating the Tax Transparency Code to include CbC reporting provide a suitable basis for a mandatory transparency reporting framework? If so, why?

What sorts of entities (based on revenue or entity structure) should this mandate apply to?

Please provide details of any compliance costs associated with adopting the Tax Transparency Code for public CbC reporting.

If the Tax Transparency Code was used as a basis for mandating CbC reporting in Australia, are there additional tax disclosures that MNEs should be required to report, such as related party expenses, intangible assets, deferred tax and effective tax rate (ETR) per jurisdiction?

As detailed above, PSI and ITUC favour the adoption of the GRI tax standard. We stress the importance of a mandatory standardized reporting, easy to use and with limited room for creative accounting.

Questions 10-15. How should entities be required to publicly report their CbC information? Would publication in their annual report be adequate? Should this CbC data be verifiable (via independent audit, certification letter from CFO, reconcilable with financial accounts etc)?

What role should Government play in reviewing, publishing and aggregated analysis of country-by-country data?

What is the most appropriate way to ensure consistent (standard) reporting by MNEs of their public CbC information?

Should the data be reported in a standardised template? What should this be?

When should mandatory tax transparency reports fall due? For example, should they occur at the same time as annual reports are produced, tax returns lodged, or be staggered to spread compliance burdens?

Are there any transitional arrangements that would need to be considered prior to commencement of a legislated reporting requirement? What would these be?

MNEs could usefully integrate country-by-country reporting to their annual financial report. This would in particular offer the advantage of mandatory audit. As far as large MNEs are concerned, the data publicly reported should to a large extent be similar to the one provided confidentially to the tax administration as part of Action 13. The Australian government should as a result be able to verify, on its own accord or upon request, consistency between the two standards.

The Australian government should also set up a centralised repository for all reporting, in a standardised format, easily accessible, searchable and machine readable.

Questions 20-25. In considering a disclosure requirement, should the entity's tax residency status be used as the definition of 'tax domicile'?

Are there any unintended consequences that may arise from this new information requirement? If yes, what are they?

How should this commitment be implemented?

Should entities disclosing this information be subject to any verification process, having regard for compliance costs (for both taxpayers and government)?

Are there any general compliance cost considerations the Government should take into account in requiring Government tenderers to disclose their country of tax domicile?

We support expanded tax reporting and compliance requirements for corporations receiving public funds and welcomes the Treasury's Consultation Paper on Shadow Economy Procurement Connected Policy. PSI intends to make a submission to the consultation. Government spending constitutes a significant percentage of economic activity and should be harnessed to promote decent work, quality public services, social cohesion, sustainability and good governance. We note the progress by the ACT government in particular in considering a range of factors in assessing procurement (draft ACT insourcing framework). Improved federal requirements should also be promoted to states, territories and local government.

Annexed to this submission Is a document, prepared by the Center for International Corporate Tax Research and Accountability (CICTAR), containing six case studies of MNEs that all receive Australian government funding and appear to be engaged in aggressive tax avoidance (Annex 1). These case studies demonstrate the need to apply the reforms discussed in this submission to all entities and particularly to those receiving public funds.

The proposed provisions should apply to all entities receiving public funds over the designated amount and should not be limited to tendering processes. Entities engaged to deliver any government / public service should be required to comply with the GRI standard and report their ETR on a jurisdictional basis.

Entities receiving public funds should be required to disclose information of the entire corporate body, not only the entity receiving, or seeking, public funds. This disclosure follows the proposals for unitary taxation and GRI standards described above.

The provisions described in this submission should apply to all bodies with income or contracts within the designated range. Research conducted by CICTAR has revealed the use of tax havens and secrecy jurisdictions by a range of entities, including not for profit entities[6], family-owned entities[7] and companies limited by guarantee[8].

END.

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[6] See for example, Caring for Growth, Australia's Largest Non Profit Aged Care Operators, CICTAR, https://cictar.org/caring-for-growth-australias-largest-non-profit-aged-care-operators/
[7] See for example, All in the Family: Tax and Financial Practices of Australia's Largest Family Owned Aged Care Companies, CICTAR 2019, http://cictar.org/all-in-the-family-tax-and-financial-practices-of-australias-largest-family-owned-aged-care-companies/
[8] See Bupa's aged care homes failing standards across Australia available at - https://cictar.org/bupas-aged-care-homes-failing-standards-across-australia/

Centre for
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Why Australia Needs New Laws to Tackle Tax Avoidance Using Royalties (including service fees other related party payments)

US Tech (& Consulting) Giants with Substantial Government Contracts

The following six multinational corporations have been winning large government contracts in Australia in recent years but appear to have a track record of aggressive tax avoidance. One of the key schemes these corporations have used is offshore related party payments, including royalties and other similar service charges. The following case studies are based on existing CICTAR research and likely represent broader practices of other multinationals operating in Australia. The analysis is largely based on ATO data, financial statements of subsidiaries and company annual reports. Source materials, citations and deeper analysis can be provided.

Accenture

Recent ATO data for Accenture (since 2016-17) lists total income between $1.8 billion and $2.2 billion per year in Australia, but annual corporate income tax payments below $40 million. This represents an average estimated profit margin of about 5% in Australia, while globally Accenture reported profit margins over the same period of closer to 15%. This appears to be an indication that Accenture shifts significant profits out of Australia to artificially reduce taxable income and fits with settlements for tax avoidance charges in other jurisdictions.

In 2018, Accenture's Australian subsidiary reported related party transactions of nearly $1.1 billion, equivalent to half of its $2.1 billion in revenue. These related party expenses, included **$576 million in consulting services**, **$97 million in international service expense**, **$8 million in other service expense** and **$156 million in royalty payments**. The pattern continued in 2021 with revenue climbing to $2.3 billion, but pre-tax profit or only $113 million. The $839 million in related party transactions included **$527 million of 'purchase consulting services'**, **$178 million in royalty expense**, **$123 million in international service expense** and **$11 million in other service agreement expense**. Some portion of these expenses may be legitimate business cost, but much of it may be artificial transactions to shift profits to low tax jurisdictions.

Accenture is listed on the New York Stock Exchange but incorporated in Ireland. The Australian business is owned via a Dutch subsidiary. Accenture was initially incorporated in Bermuda, after the company re-branded from Arthur Andersen following the infamous collapse of Enron.

Amazon

Amazon has three primary subsidiaries in Australia. Based on ATO data, AWS Australia Pty Ltd, its local cloud computing business is the most profitable with an estimated profit margin of 10% in 2019-20. However, profit margins for Amazon's global AWS segment are 30% or higher. The Australian subsidiary had total income of $600 million and taxable income of $55 million in 2019-20. Some of the AWS revenue in Australia, including from some government contracts, may have been paid directly to a Delaware entity rather than Australian entity. The 2021 filing of AWS Australia Pty Ltd reported revenues over $1 billion, but "administrative expenses" of $1.1 billion resulted in a reported loss. The subsidiary's related party expenses included a **"cloud service fee" of over $223 million** and **$55 million for intangible assets**. These royalty type payments dramatically reduce taxable income in Australia.

IBM

IBM's Australian subsidiary is owned via the Netherlands but financed through a "Treasury Services" company in Ireland. This Irish entity, despite funnelling billions to and from subsidiaries around the world, is exempt from filing financial returns. In Australia, IBM has billions in total income, but very little in taxable income and did not pay any corporate income tax for years running. In 2019-20, IBM

did have tax payable of $15 million on taxable income of $131 million and total income of $2.9 billion. The 2020 filings of IBM A/NZ Holdings Pty Ltd reveal that in 2019 it made a provision of $28 million to correct underpayments in previous years and that it had "issues under discussion" with the ATO. The Australian subsidiary paid out **$363 million in royalty and software license fees** in 2020, which were *equivalent to 75% of the company's annual operating costs*. This does not include a **"Business Service Fee" expense of $197 million** in 2020 paid to other related parties or $100 million in interest on related party debt.

Microsoft (forthcoming report)
According to ATO data, Microsoft's subsidiaries in Australia have an estimated profit margin over the last 2 years of 7.4%, while its global profit margins over the same period are above 30%. According to the 2021 filing of Microsoft Pty Ltd, its calculated profit margin would be only 4.5% compared to a global profit margin of 42.3%. The Australian subsidiary had 2021 revenue of over $5 billion, with pre-tax profit of $231 million and an income tax expense of $91 million. In 2021, Microsoft's primary Australian subsidiary purchased ***over $3.4 billion in goods and services from related parties, equivalent to 70% of its total revenue***. The lack of detail in Australian filings make it hard to determine the related party payments specifically for royalties or service fees. As with other US IT multinationals, the primary Australian subsidiary is owned via an Irish subsidiary, directly owned by another Luxembourg subsidiary. The Irish subsidiary reported income from royalties of US$33.5 billion in 2020.

McKinsey
Based on ATO corporate tax data, McKinsey Pacific Rim Inc – McKinsey's Australian subsidiary – has had estimated profit margins of zero to 1% in the last two years. In 2019-20, its total income of $436 million was reduced to taxable income of $3.7 million. It paid $1 million in taxes. In 2020, McKinsey Pacific Rim Inc had a total of $125 million in related party expenses, which included **"firm function expenses" of $43 million** and **royalties of $15 million**. A fellow Delaware subsidiary acts as clearing house for global related party transactions. These related party expenses are likely one of the means used to artificially reduce taxable income in Australia. McKinsey currently faces allegations of tax fraud for its operations in France, also heavily reliant on government contracts. Although a global consulting giant, US-based McKinsey is a private company.

Oracle
Oracle is currently in a massive $300 million transfer pricing dispute with the ATO. This might be the largest case of profit shifting since the landmark Chevron settlement in 2017 and indicates profit shifting of nearly $1 billion in income. In 2021 the New Zealand tax authority alleged the Oracle underpaid NZ$20 million in tax between 2012 and 2015, "by overpaying for services supplied by its overseas parent". Oracle's New Zealand filings contain more detail on related party transactions than the Australian filings. In 2021, the New Zealand filings indicate that purchases from offshore related parties made up over 99% of the cost of products sold. The majority of related party transactions were with the Irish parent company and "included sub-license fee and hardware support fees, trading of goods and services, interest charges and purchase accounting entries."

As with other tech giants, Oracle reports global profit margins off above 30%, but the Australian business, on paper and for tax purposes, barely breaks even. In 2021, Oracle Corporation Australia Pty Ltd reported revenue of $1.3 billion but pre-tax profits of below $2.8 million. Related party transactions amounted to $833 million, including **$538 million in "Sub-license fee and hardware support fee"**. Oracle's primary Australian operating company is owned through a complex corporate structure leading to Ireland. The top entities have been non-resident companies, registered in the Isle of Man, and not subject to income tax in Ireland, or anywhere else.