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Submission in response to 'Re:think. Tax discussion paper'
1 June 2015

The Justice and International Mission Unit, Synod of Victoria and Tasmania, Uniting Church in Australia welcomes this opportunity to make a submission to the *Re:think. Tax discussion paper*. This submission is complementary to the submissions made by UnitingJustice Australia and UnitingCare Australia. It seeks to expand on the broad positions made by those submissions on two of the questions in the discussion paper.

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Q. 3. How important is it to reform taxes and boost economic growth? What trade-offs need to be considered?

The Unit is deeply concerned that changes are not implemented to the tax system that increase the current level of inequality in Australia. There is increasing evidence that increasing inequality stifles economic growth.

Piketty points out "there is a set of forces of divergence associated with the process of accumulation and concentration of wealth when growth is weak and the return on capital is high."[1] His data shows substantial growth in income inequality in the OECD countries he examined and in the US this "spectacular increase in inequality largely reflects an unprecedented explosion of very elevated incomes from labour, a veritable separation of the top managers of large firms from the rest of the population."[2] The work by Andrew Leigh suggests that Australia faces a similar problem with real wages for the bottom tenth having risen 15%, while wages for the top tenth have risen 59%. Cumulatively, the increase in inequality over the past three decades represents a $365 billion shift from the bottom 99% to the top 1%. His work found the richest 50 people in Australia have more wealth then the bottom two million.[3]

Piketty points to increasing wealth inequality, which he argues is the result of the rate of return on capital remaining significantly above the growth rate for an extended period of time.[4] He points out the consequence is:[5]

> *….then it logically follows that inherited wealth grows faster than output and income. People with inherited wealth need save only a portion of their income from capital to see that capital grow more quickly than the economy as a whole. Under such conditions, it is almost inevitable that inherited wealth will dominate wealth amassed from a lifetime's labour by a wide margin, and the concentration of capital will attain extremely high levels – levels potentially incompatible with the meritocratic values and principles of social justice fundamental to modern democratic societies.*

IMF staff report there is a tentative consensus in the literature that "inequality can undermine progress in health and education, cause investment-reducing political and economic instability, and undercut the social consensus required to adjust in the face of shocks, and thus that it tends to reduce the pace and durability of growth."[6]

The IMF staff report that lower net inequality is robustly correlated with faster and more durable growth, for a given level of redistribution.[7]

According to a report by the ACTU, high wealth and income inequality can directly trigger financial crisis, by creating unsustainable demands for investment options among the

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[1] Thomas Piketty, 'Capital in the Twenty-First Century', The Belknap Press of Harvard University Press, London, 2014, p. 23.
[2] Thomas Piketty, 'Capital in the Twenty-First Century', The Belknap Press of Harvard University Press, London, 2014, p. 24.
[3] Andrew Leigh, 'Gap between haves and have nots must be narrowed', *The Australian,* 21 April 2014.
[4] Thomas Piketty, 'Capital in the Twenty-First Century', The Belknap Press of Harvard University Press, London, 2014, p. 25.
[5] Thomas Piketty, 'Capital in the Twenty-First Century', The Belknap Press of Harvard University Press, London, 2014, p. 26.
[6] Jonathan D. Ostry, Andrew Berg and Charalambos G. Tsangarides, *Redistribution, Inequality and Growth,* IMF Staff Discussion Note SDN/14/02, February 2014, p. 4.
[7] Jonathan D. Ostry, Andrew Berg and Charalambos G. Tsangarides, *Redistribution, Inequality and Growth,* IMF Staff Discussion Note SDN/14/02, February 2014, p. 4.

wealthiest individuals, which fuels cheap debt, that is consumed by the poorest individuals. Eventually this dynamic can lead to massive debt defaults and financial crisis.[8]

Emerging evidence also links economic inequality with decreased psychological wellbeing and poor health. Wilkinson and Picket's *The Spirit Level* linked directly the major health and social problems to levels of income inequality through an analysis of OECD countries. People living in unequal societies were several times more likely to be in jail, be mentally ill, be obese, be murdered and have higher infant mortality. Whilst there have been critiques of both their methodology and statistical analysis, their observations do point to inequality being a factor that impacts on many social indicators of well-being for a society.

Income inequality also impacts on people's opportunity to move beyond or out of their social sphere meaning the question of luck as to which sort of family you were born into becomes a large determinant of where you end up.[9]

IMF staff have pointed out that measures that address inequality through redistribution do not necessarily have a negative impact on economic growth:[10]

> *Equality-enhancing interventions could actually help growth: think of taxes on activities with negative externalities paid mostly by the rich (perhaps excessive risk-taking in the financial sector) or cash transfers aimed at encouraging better attendance at primary schools in developing countries, as examples. The macroeconomic effects of redistributive policies will reflect a balance between the components of the fiscal package, and it is an empirical question whether redistribution in practice is pro- or anti-growth.*

They declared that inequality is harmful for growth, that "lower inequality seems to be associated with longer growth spells"[11], affirming the 2011 Berg and Ostry finding that "multi-decade and multi-country evidence demonstrates that greater equality can help sustain growth...apart from ethical, political, or broader social considerations."[12]

They found that redistribution appears generally benign in terms of its impact on growth; only in extreme cases is there some evidence that it may have direct negative effects on growth. They conclude the combined direct and indirect effects of redistribution – including the growth effects of the resulting lower inequality – are on average pro-growth. [13]

[8] D. Neale et. al., *Australian Attitudes towards wealth inequality and progressive taxation: A national survey of knowledge, attitudes and perceptions of wealth inequality and progressive taxation*, A report prepared for the ACTU, 15 April 2011, p.3

[9] A. Leigh, *Battlers and Billionaires: the Story of Inequality in Australia*, Redback, Collingwood, 2013, p.91.

[10] Jonathan D. Ostry, Andrew Berg and Charalambos G. Tsangarides, *Redistribution, Inequality and Growth,* IMF Staff Discussion Note SDN/14/02, February 2014, p. 4.

[11] Jonathan D. Ostry, Andrew Berg and Charalambos G. Tsangarides, *Redistribution, Inequality and Growth,* IMF Staff Discussion Note SDN/14/02, February 2014, p. 21

[12] Jonathan D. Ostry, Andrew Berg and Charalambos G. Tsangarides, *Redistribution, Inequality and Growth,* IMF Staff Discussion Note SDN/14/02, February 2014, p. 21

[13] Jonathan D. Ostry, Andrew Berg and Charalambos G. Tsangarides, *Redistribution, Inequality and Growth,* IMF Staff Discussion Note SDN/14/02, February 2014, p. 4.

Q. 34. How can tax avoidance practices such as transfer pricing be addressed without imposing an excessive regulatory burden and discouraging investment.

34.1. Recommendations

The Australian Government should continue to maintain its reputation and provide leadership on tackling tax dodging by Multinational Enterprises (MNEs), as the past President of the G20 in 2014. The Justice and International Mission Unit makes the following recommendations to address base erosion and profit shifting. The Australian Government should:

1. Continue to support the ATO working collaboratively with other tax authorities around the world to combat cross-border tax avoidance and tax evasion by multinational enterprises. This should include continuing to build up a regional multilateral body of tax authorities in the Asia-Pacific region.
2. Require greater transparency from multinational corporations, including country-by-country reporting. Consolidated annual reports should include revenues, profits, staffing levels and taxes paid in each country in which they operate or have subsidiaries. These reports should be made public for the benefit of investors, those that need to do business with multinational enterprises and to ensure the confidence of the general public that profits of multinational enterprises are being taxed where the economic activities deriving the profits are performed and where value is created.
3. Remove the ability of Australian subsidiaries of large foreign multinational companies to be able to claim exemption from the parts of the *Corporation Act* that require financial reporting.
4. The 1995 exemption for around 1,500 companies to filing annual reports with the corporate regulator should be rescinded.
5. Privately owned companies should not be exempted from the tax transparency measures contained in the *Tax Laws Amendment (2013 Measures No. 2) Act.*
6. On 18 March 2015 the European Commission announced a proposal to introduce the automatic exchange of information between EU members on their tax rulings.[14] This is a further tax transparency measure that Australia should support as becoming a global norm.
7. Support the development of a new international standard to eventually replace the OECD arm's length principle using combined reporting, with formulary apportionment and Unitary Taxation.
8. Ensure the implementation of automatic exchange of information between tax authorities using the Common Reporting Standard, with adoption by Australia no later than 2018.
9. Support moves internationally to apply a formulaic apportionment of debt across a multinational enterprise based on the substance of its operations rather than on artificial legal structures.
10. Continue to support the OECD's Action Plan on Base Erosion and Profit Shifting (BEPS) and pressure secrecy jurisdictions to end their status as such through effective cooperation with other governments to combat tax evasion, tax avoidance and money laundering.
11. Support the OECD BEPS Action Plan Action 15 recommendation to work towards a multilateral tax convention.
12. Ensure that the Australian Tax Office is adequately funded and staffed.
13. Implement measures that seek to penalise secrecy jurisdictions that refuse to provide effective information exchange to encourage them to comply with automatic information

[14] European Commission, 'Combatting corporate tax avoidance: Commission presents Tax Transparency Package', Media Release, 18 March 2015.

exchange and other global standards addressing money laundering, tax avoidance and tax evasion. Such measures should include:

- Disallowing deductions or credits with respect to transactions with residents of a jurisdiction that does not effectively exchange information (which is already used by Argentina, Brazil, Germany, India and Italy);
- Applying higher rates of withholding taxes on all transfers of funds to jurisdictions that do not engage in effective information exchange (which is already used by Argentina, France, Mexico and the Slovak Republic);
- Deeming funds received from a secrecy jurisdiction that does not provide automatic information exchange to be assessable income; and
- The application of administrative measures which discourage companies from using non-co-operative jurisdictions, such as reversing the burden of proof, higher audit requirements and requiring records to be kept for 20 years rather than the standard five years for records involving the use of secrecy jurisdictions that do not commit to automatic information exchange.

14. Introduce a requirement for a public register of the ultimate beneficial owners of companies, given the role shell companies and special purpose entities play in both tax dodging and many forms of illicit flows.[15] Australia should also support this becoming a global standard.
15. Introduce legislation, modelled on a combination of both US and UK legislation, to protect and reward private sector whistleblowers that expose tax evasion, tax avoidance and fraud against all levels of government in Australia. The reward should be a proportion of any funds recovered as a result of the information provided by the whistleblower.
16. Do not give into lobbying by MNEs and introduce patent box rules similar to the UK or other European jurisdictions that serve to cheat other jurisdictions of tax revenue they should otherwise be entitled to as well as being likely to reduce Australian corporate tax revenue.
17. The corporate income tax rate should not be reduced as a measure to reduce tax avoidance.

34.2. Evidence of Corporate Tax Dodging in Australia

We are in the middle of a period where some governments have devised tax systems which deny other governments revenues which they should clearly be entitled. In the most egregious (and all too common) cases, MNEs shift profits to low tax secrecy jurisdictions despite having little more than a token legal presence in these countries.

In the old way business worked, an investor would weigh up a country based on a whole host of factors. How stable is the government, how well will the court system enforce contracts, how educated is the workforce, how effective the police force is to protect them from criminal activity, and how good are the roads, railways, internet and telecommunication systems. The tax rate is also a factor, but just one factor. Tax is the thing that pays for all the other things an investor wants in order to be able to profit from their investment.

Over time some governments have made it their business to offer opportunities for investors to shift their profits away from the places where the business activity is actually taking place and avoid paying taxes to support all the services the business wants to be able to operate. So the business gets all the things it wants that allow it to make a profit and gets others to pay for them.

This is not about tax competition, as some neo-liberal lobby groups would like to argue, but it is the illegitimate theft of tax revenue by governments that should have no entitlement to the

[15] Global Witness, 'Undue Diligence. How banks do business with corrupt regimes', March 2009, pp. 109-111.

tax revenue, as they have provided nothing of substance to the business being conducted, but are happy to facilitate tax avoidance for their own benefit. This is a classic 'beggar thy neighbour' regime which undermines economic cooperation and global growth. Thus, when a multinational enterprise has subsidiaries in jurisdictions known to facilitate tax avoidance, it should be a matter of concern. Further, when an Australian multinational enterprise sets up subsidiaries in a jurisdiction known to facilitate tax avoidance, especially when alternative choices were readily available, it should also be a matter of concern. At the very least, it might be seen that the multinational enterprise is rewarding the jurisdiction for not being compliant with global norms for combating money laundering and financing or terrorism (such as those developed by the Financial Action Taskforce (FATF)).

The point has been acknowledged by the ATO:[16]

> *The ability to separate income and economic activity is what gives rise to unfair tax competition – it is unfair because it attempts to delink the mutually cooperative nature of tax and the economy. Low tax jurisdictions attract the income without the economic investment and it does them little good. Productive economies lose the income and lose the ability to sustain themselves.*

Further, Deputy Commissioner of Taxation, Mark Konza, was quoted in the press in November 2014 as having said if governments "parasitically attract paper income away from places where economic activity is taking place that's unfair tax competition, and the G20 and most countries concede that's not acceptable."[17]

The response from MNEs and their tax advisers is usually to blame the governments that are facilitating the tax avoidance for the existence of those arrangements. The argument is usually that the government facilitating the tax avoidance has created a legal avenue for such activity to take place and that it should not be expected that MNEs will not take advantage of such arrangements. As Kevin Nicholson, Head of Tax, PricewaterhouseCoopers LLP (UK), told the UK Public Accounts Committee on 8 December 2014:[18]

> *I am not here to defend the Luxembourg tax regime or how the inspector operates, but we do abide by the law—we abide by the procedures that Luxembourg puts in place. We can't get away from the fact that these are Governments—economies—that are competing with each other for taxation. That is at the heart of the issue, and the heart of the solution is BEPS and the OECD making sure that Governments do not compete in that way so we don't have the mismatches that you are looking at here.*

The countries offering the service to facilitate the tax avoidance have been happy to take a small clip of the ticket as their reward for assisting in the tax theft, as they have not had to provide any of the services the business needs to operate and make a profit. As the recent leaks of all the dodgy deals done in Luxembourg show, this facilitation of tax avoidance is usually done in secret. Many of these dodgy deals might be illegal, at least under the laws of the countries that have been cheated. Part of the problem is due to a cloak of secrecy

[16] Mark Konza, 'Global tax avoidance and its effects on Australia's economic prosperity', Sydney, ATO Media Centre, 26 August 2014, https://www.ato.gov.au/Media-centre/Speeches/Other/Global-tax-avoidance-and-its-effects-on-Australia-s-economic-prosperity/

[17] Nassim Khadem, 'ATO revokes multinationals' tax deals', *The Australian Financial Review,* 7 November 2014, p. 11.

[18] UK Public Accounts Committee, 'Oral evidence: Tax avoidance: the role of large accountancy firms - follow-up, HC 860', 8 December 2014 , p. 7, http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/public-accounts-committee/tax-avoidance-the-role-of-large-accountancy-firms-followup/oral/16207.pdf

surrounding the tax arrangements of multinational companies and a lack of transparency in the way they report on their activities.

We will need to wait and see what legal actions result against companies that have been involved in the dodgy arrangements that were provided by Luxembourg. Further, just because a tax cheat is not prosecuted, does not mean what they did was legal. It may mean the country the revenue was stolen from believes the legal action is too expensive to pursue for the return that can be gained.

Like most of the international community, the Synod of Victoria and Tasmania opposes governments acting as 'secrecy jurisdictions', as their lack of adequate regulation and provision of secrecy assists in tax avoidance, tax evasion and money laundering of all forms of illicit financial flows. 'Secrecy jurisdictions' provide laws and regulations that offer secrecy to those depositing funds within their borders. They undermine the ability of other governments, elected by their citizens, to levy taxes in a just and fair way, by providing a loophole for the wealthiest to escape paying their fair share of tax. Global good governance is undermined when governments choose to act as 'secrecy jurisdictions'.

While many 'secrecy jurisdictions' are also defined as 'tax havens', the definitions of the two are different. The Australian Taxation Office (ATO) has also used the language of 'secrecy jurisdictions'.[19]

The definition of a secrecy jurisdiction is in three parts.[20] Firstly, secrecy jurisdictions are places that intentionally create regulation for the primary benefit and use of those not resident in their geographical domain. It must deliberately create laws that wholly or mainly relate to activities that take place 'elsewhere' as far as it is concerned.

Secondly, a secrecy jurisdiction deliberately designs the regulation they create for use by people who do not live in their territories so that it undermines the legislation or regulation of another jurisdiction.

Thirdly, the secrecy jurisdiction creates a deliberate, legally backed veil of secrecy that ensures those from outside the jurisdiction making use of its regulation cannot be identified to be doing so. While all three of these characteristics must be present for a country to be considered a secrecy jurisdiction, this third characteristic is the most important.

The Tax Justice Network has developed an index for secrecy jurisdictions, the Financial Secrecy Index[21], and has released a ranking of jurisdictions in 2009, 2011 and 2013. The Financial Secrecy Index (FSI) provides a secrecy score for each jurisdiction based on about 49 of the 202 criteria employed in the FSI database being used to construct 15 different secrecy indicators. The choice of the indicators is necessarily subjective – but an objective list does not exist, and never will. The Tax Justice Network aimed to produce the next best thing: a list that is plausible, comprehensive, transparent and as short as possible. It relied on expert input to make its selection.

The FSI indicators are designed to provide clear pointers for policy change to help jurisdictions become more transparent.

The 15 indicators are as follows (shown in no particular order):

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[19] Australian Taxation Office, 'Compliance Program 2011-12', June 2011, pp. 25, 33.
[20] Tax Research LLP, 'Research Briefing – Secrecy Jurisdictions', Financial Integrity and Economic Development Task Force, Tax Justice Network, Tax Research UK, September 2010, http://www.taxresearch.org.uk/Documents/Secrecyjurisdiction.pdf
[21] Financial Secrecy Index, http://www.financialsecrecyindex.com

1. Banking secrecy: Does the jurisdiction have banking secrecy?
2. Trust and Foundations Register: Is there a public register of Trusts or Foundations, or are trusts and foundations prevented? This applies both to local trusts and foundations, as well as to local management of foreign trusts.
3. Recorded Company Ownership: Does the relevant authority obtain and keep updated details of the beneficial ownership of companies?
4. Public Company Ownership: Does the relevant authority make details of ownership of companies available on public record online for less than US$/€10?
5. Public Company Accounts: Does the relevant authority require that company accounts are made available for inspection by anyone for a fee of less than US$/€10?
6. Country-by-Country Reporting: Are all companies required to comply with country-by-country financial reporting?
7. Fit for Information Exchange: Are resident paying agents required to report to the domestic tax administration information on payments to non-residents?
8. Efficiency of Tax Administration: Does the tax administration use taxpayer identifiers for analysing information effectively, and is there a large taxpayer unit?
9. Avoids Promoting Tax Evasion: Does the jurisdiction grant unilateral tax credits for foreign tax payments?
10. Harmful Legal Vehicles: Does the jurisdiction allow cell companies and trusts with flee clauses?
11. Anti-Money Laundering: Does the jurisdiction comply with the FATF recommendations?
12. Automatic Information Exchange: Does the jurisdiction participate fully in Automatic Information Exchange such as the European Savings Tax Directive?
13. Bilateral Treaties: Does the jurisdiction have at least 46 bilateral treaties providing for information exchange upon request, or is it part of the European Council/OECD convention?
14. International Transparency Commitments: Has the jurisdiction ratified the five most relevant international treaties relating to financial transparency?
15. International Judicial Cooperation: Does the jurisdiction cooperate with other states on money laundering and other criminal issues?

In Australia a number of business bodies have attacked the use of the term ‘secrecy jurisdiction’, but the Synod has not seen any serious critique of the FSI and its methodology. The Synod believes the use of the secrecy jurisdiction concept is very helpful, as it is identifying jurisdictions that are providing secrecy and failing to live up to international standards on transparency and combating money laundering. This is different from a jurisdiction that simply provides low tax rates.

As the FSI relies on assessment against a set of criteria, it captures jurisdictions that have high secrecy scores that would not traditionally be regarded as tax havens.

We recognise that there can be legitimate reasons for a multinational company locating a subsidiary in a secrecy jurisdiction. However, at the same time choosing to set up companies in a secrecy jurisdiction, when other choices exist, can reward the government of that jurisdiction for maintaining laws that can facilitate tax evasion, money laundering and tax avoidance. It can also undermine corporate transparency and accountability more broadly.

The ATO reported that in 2012 Australian tax payers that submitted International Dealing Schedules had financial transactions with the following secrecy jurisdictions:[22]

- Andorra;
- Anguilla;
- Dominica;
- Gibraltar;
- Nauru;
- Panama;

[22] ATO Document 7 of FOI release to the Synod of Victoria and Tasmania, IDS external overview, undated.

- Antigua and Barbuda;
- Aruba;
- Bahamas;
- Bahrain;
- Belize;
- Bermuda;
- BVI;
- Caymans;
- Cook Islands;
- Curacao;
- Grenada;
- Guernsey;
- Isle of Man;
- Jersey;
- Liberia;
- Liechtenstein;
- Marshall Islands;
- Mauritius;
- Monaco;
- Montserrat;
- Saint Kitts and Nevis;
- Saint Lucia;
- Saint Martin (Dutch part);
- Saint Vincent and the Grenadines;
- Samoa;
- San Marino;
- Seychelles;
- Turks and Caicos Islands;
- US Virgin Islands; and
- Vanuatu

The ATO has noted that between 2005 and 2011 there was a 49% increase in the number of controlled entities in havens and low tax jurisdictions by ASX100 entities.[23]

The ATO has noted that there are a growing number of entities transacting with related parties in tax havens and low tax jurisdictions with significant transaction values, particularly Singapore, Switzerland, Ireland and Hong Kong.[24] The top five countries for transfers of intangible property are USA, Singapore, Japan, Switzerland and Ireland.[25]

The ATO reported there are a growing number of MNEs transacting with related parties in tax havens and low tax jurisdictions.[26] The Synod believes this opens up corporate tax revenue to greater risks of tax avoidance. The ATO provided a table based on the 2012 International Dealing Schedules submitted by MNEs, which is reproduced below.

Table 1. MNEs operating in Australia related party dealings with secrecy jurisdictions for 2012

Jurisdiction	Number of Entities	Value ($ billions)
Switzerland	48	35.7
Singapore	180	36.4
Ireland	21	3.5
Barbados	3	2.4
Hong Kong	102	2.2
Bermuda	34	1.9
Luxembourg	17	0.4
British Virgin Islands	19	0.4
Belgium	13	0.1

The ATO documents show that just 10 MNEs accounted for 75% of the expenditure transferred to Singapore as reported in International Related Party Dealings (IRPD) schedules submitted for 2012.[27] The top MNE had $11.7 billion of expenditure transferred to Singapore, with the second top MNE having $6.2 billion of expenditure, rapidly dropping to $731 million of expenditure with Singapore for the 10th highest entity.[28]

The ATO reported in a February 2013 document around the development of a treaty with Switzerland analysed the 36 MNEs with Swiss IRPD and revealed concerns that many of

[23] Australian Taxation Office, 'Corporate Transparency Overview', September 2013, p. 12.
[24] Australian Taxation Office, 'Corporate Transparency Overview', September 2013, pp. 1, 11.
[25] Australian Taxation Office, 'Corporate Transparency Overview', September 2013, p. 1.
[26] Australian Taxation Office, 'Corporate Transparency overview', September 2013, p. 11.
[27] William Wong, 'Response to further questions raised by the Inland Revenue Authority of Singapore on 22 May 2014', Australian Taxation Office Memo, 27 May 2014, p. 3.
[28] William Wong, 'Response to further questions raised by the Inland Revenue Authority of Singapore on 22 May 2014', Australian Taxation Office Memo, 27 May 2014, p. 3.

them may have engaged in activities "with potentially negative tax consequences".[29] The total tax payable from the 36 entities with Swiss IRPD in 2011 was $9.2 billion.[30] Most of the tax payable by MNEs with Swiss IRPD was attributable to mining companies, with Swiss related tax payable from the mining sector making up 79.8% of the tax payable in 2012.[31]

Globally, the OECD has identified the following key areas of risk in terms of aggressive tax practices by multinational corporations:[32]

- International mismatches in entity and instrument characterisation including hybrid mismatch arrangements and arbitrage;
- Application of treaty concepts to profits derived from the delivery of digital goods and services;
- The tax treatment of related party debt-financing, captive insurance and other inter-group financial transactions;
- Transfer pricing, in particular in relation to the shifting of risks and intangibles, the artificial splitting of ownership of assets between legal entities within a group, and transactions between such entities that would rarely take place between independents;
- The effectiveness of anti-avoidance measures, in particular GAARs, CFC regimes, thin capitalisation rules and rules to prevent tax treaty abuse; and
- The availability of harmful preferential regimes.

Australia is not immune from such practices. One of the apparent reasons for this has been a shift in the nature of multinational companies. Due to changes in corporate governance practice and (from an Australian perspective) the Corporate Law Economic Reform Program (CLERP) amendments to Corporations Law, the profit making objective can no longer be assumed for Australian resident incorporated legal entities controlled by other corporations, particularly those controlled by foreign corporations.

CLERP amendments to director's obligations included a watering down of director's duty to act in the best interests of the company. The law now permits directors to act in the best interests of the company's holding company, providing the subsidiary company's constitution expressly authorises directors to do so. Directors are still required to act honestly, but while there may be honesty when reporting to shareholders, the same could not always be said in relation director's obligations under law in their reporting to ASIC and the ATO

While CLERP amendments have theoretically resolved a conflict of interest problem for directors of subsidiaries, they have weakened the government's defences against tax avoidance.

Prior to 1990, multinational corporate governance practices generally followed a body corporate model that had progressively developed from around the 1600s. Each body corporate was governed by a board which delegated its authority to the officers of the company for purposes of pursuing the body corporate's profit making objective. Subsidiaries of multinational enterprises generally followed the same model although it was common practice for directors, when acting in the best interest of the company, to also seek considered sound advice from shareholders before embarking on major proposals.

Holding companies from around the 1980s began moving rapidly from sovereign to regional and then to borderless intra group global governance structures to better co-ordinate the needs of multinational clients. To co-ordinate these global operational aspirations,

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[29] Australian Taxation Office, 'Switzerland Treaty. ATO Input', February 2013, pp. 4-5.
[30] Australian Taxation Office, 'Switzerland Treaty. ATO Input', February 2013, p. 5.
[31] Australian Taxation Office, 'Switzerland Treaty. ATO Input', February 2013, p. 6.
[32] OECD, 'Addressing Base Erosion and Profit Shifting', OECD Publishing, http://dx.doi.org/10.1787/9789264192744-en, 2013, pp. 47-48.

multinational parent entities began watering down authorities of local boards and then began opting for direct control of local operations. Authority delegations from the parent entity had also become borderless. Sovereign and legal entity borders were ignored and staff in subsidiary companies began reporting direct to managers in the parent company's head office.

Local boards of directors were bypassed and generally ignored by local staff unless instructed by their own global line management to follow directions of the local board. Local boards became little more than window dressing to preserve perceptions by the general public and local authorities (particularly tax authorities) that nothing had changed. Some even mirrored global authority delegations with local versions, but generally speaking it would be unusual for local staff of multinationals to be aware of anything other than global authority delegation structures.

The changes to the governance model, from local to global, may have started with the objective of better meeting client needs, but global tax managers were quick to realise that their new governance models would allow them to instruct staff employed by local legal entities to adopt tax avoidance strategies that would reduce income in high tax countries, supposedly moving the source the group's income to low or zero tax jurisdictions or shifting costs to high tax jurisdictions. Group discounts, which are in part based on contributions by subsidiaries in high tax countries are, of course, not shared with those subsidiaries.

Initial resistance to the parent's profit shifting measures was overcome by changing local performance measurement and objectives. Performances were no longer measured as a function of profit (or profit after tax) at the legal entity level because it was recognised that local staff (and directors) had no control over the parent's decisions to implement transactions that were not in the best interest of the subsidiary. Examples include; high debt levels, discounted sales to the group's subsidiaries in low tax jurisdictions, charging service fees that have no relationship to the needs of the local businesses and charging royalties or franchise fees for IP already owned by the local operating companies (or which were bought out cheaply).

Local statutory financial information is usually only disseminated within the company's finance staff and then only on a need to know basis. Directors themselves are often not aware. It is our understanding from speaking to former employees of some companies, that some parent companies even forbid the local board and finance staff from sharing such information with other staff.

The *Corporations Act* and its predecessors were enacted for the purpose of regulating Body Corporates. However, for reasons discussed above, there is significant evidence to indicate that many multinational subsidiaries no longer function as body corporates.

Generally speaking, there is concern that Australian staff employed by a multinational's locally incorporated legal entities often no longer take direction or authority delegation from their own board or other staff of the company that employs them. They respond to and are accountable only to their global line management. Global line management operates seamlessly across geographical and legal jurisdictions as if they were not there.

There is concern that in too many multinationals, the genesis of all authority is direct from the board of the ultimate holding company. In effect, most multinationals have evolved into one body corporate using local legal entities in an agency arrangement, to transact the business of the parent's branch operations in each country in which they operate. The legal entity structures and related party contracts are used to minimise the multinational enterprise's global tax payments.

It would be helpful if corporations law better spelt out what a body corporate either is or is not in terms of corporate governance, because too many multinational enterprises have used the evolution and enablers of global governance arrangements as a tool to run a single global body corporate while hiding behind legislation developed prior to the computer age, which is reliant on the concept of border protection, to manipulate their operations for the express purpose of tax avoidance. The fact that their behaviour relies on deception to achieve its objectives suggests that too many directors of multinationals and their subsidiaries are potentially in breach of their duty to act honestly.

The Synod of Victoria and Tasmania is concerned that the current level of confidentiality provided to MNEs by the *Taxation Administration Act 1953* makes assessment of profit shifting by MNEs operating in Australia very difficult, if not impossible, with only the ATO and the MNEs having access to the detailed information that would allow a thorough assessment to be made.

Profit shifting reduces the reportable profit of an MNE, so profit shifting is unlikely to show up in examining effective tax rates.

In financial year 2013-14 the ATO collected $67.3 billion net tax from companies, compared to $163.6 billion from individuals.[33] The ATO collected tax from 1,250 "large domestic and international businesses".[34] Relative to most other OECD countries, Australia has a high reliance on corporate income tax.[35]

Of the 2,168 entities identified by the ATO as reporting more than $100 million in total annual income and thus requiring disclosure of their tax information under the new *Tax Laws Amendment Act* ('the Corporate Transparency Population' or 'CTP'), 30 per cent did not pay tax in 2012.[36]

Economic globalisation and the expansion in e-commerce have resulted in increasing cross-border trade ($600 billion in 2012–13) and international related party dealings ($400 billion in 2012-13). In 2012 there were 7,834 International Dealing Schedules lodged by tax payers in Australia covering international related party dealings (IRPD) totalling $272 billion.[37] Singapore accounted for around 33% of total IRPD expenditure. Switzerland accounted for around 35% of total IRPD revenue. IRPD directly with China was small and, in the view of the ATO, did not reflect trade and investment.[38] The ATO concluded that there was a disparity between IRPD transactions and the pattern of Australia's international trade. In their view, given the level of IRPD, Singapore and Switzerland should be the giants of Australian trade and China relatively insignificant.[39]

Between 2006 and 2012, the IRPD dealings of the CTP increased 64% from $154 billion to $253 billion and account for approximately 7% of the CTP's total income and expenses.[40] Related party stock in trade accounted for approximately 70% of total international related

[33] Australian Taxation Office (2014), *ATO Annual Report 2013-14*, p. iii.
[34] Australian Taxation Office (2014), *ATO Annual Report 2013-14*, p. v.
[35] Australian Taxation Office (2014), *ATO Annual Report 2013-14*, p. 59.
[36] Australian Taxation Office, 'Corporate Transparency Overview', September 2013, p. 1.
[37] ATO Document 7 of FOI release to the Synod of Victoria and Tasmania, IDS external overview, undated
[38] ATO Document 7 of FOI release to the Synod of Victoria and Tasmania, IDS external overview, undated.
[39] ATO Document 7 of FOI release to the Synod of Victoria and Tasmania, IDS external overview, undated.
[40] Australian Taxation Office, 'Corporate Transparency Overview', September 2013, p. 10.

party dealings through 2006 to 2012, mainly from energy and resources and industrials entities.[41]

In 2013, there were over 6,300 businesses reporting international related-party dealings and they collectively paid $40 billion in company income tax.[42] In 2012 the ATO stated about 50% of international related party dealings were carried out by our largest 100 or so companies and almost 70% of net income tax payable was paid by companies with international related party dealings.[43]

Australia is also increasingly becoming more vulnerable to tax avoidance activities that involve intangible assets. In Australia, intangible investment increased from 20 per cent of tangible investment in 1974-75 to 44 per cent in 2005-06.[44]

In May 2013, the Australian Treasury's own assessment of base erosion and profit shifting by MNEs made the following observations:[45]

> *…. in comparison with other countries, Australia's corporate tax collections have fallen by more and recovered by less since the onset of the GFC – despite our economy growing by 13 per cent since the GFC whereas many other economies remain at or below pre-GFC levels.*
>
> *After rising consistently from 2000-01, Australia's corporate tax receipts declined significantly since the onset of the GFC in 2008. By 2011-12 gross business profits had recovered to the level expected before the crisis in the 2008-09 Budget, however, company tax collections remained well below the level expected in the 2008-09 Budget.*
>
> *Systematic analysis of developments in the effective rate of tax paid by companies operating in Australia could provide an indication of the extent of concerns around the corporate tax base. Conceptually, everything else being equal, a decline in the aggregate effective tax would be consistent with an increase in BEPS activity.*
>
> *At the aggregate level, one approach is to use the ratio of company tax (excluding capital gains tax) to net operating surplus (that is, gross business profits less depreciation) as a proxy for the effective rate of company tax. Comparing this ratio with the statutory rate of company tax provides another indicator of the integrity of the corporate tax base, although it is also affected, among other things, by the impact of policy decisions on the tax base. This measure of the aggregate effective rate of company tax was broadly stable from the reduction in the company tax rate in 2001-02 until 2008-09, when it fell significantly. While it recovered somewhat in 2011-12, it remains around 3 percentage points lower than the statutory rate.*
>
> *Another approach is to look at the available data on areas where the risk of BEPS activity is greater, such as trends in payments in relation to intangible assets and intellectual property. ABS survey data, published in the Balance of Payments, provides information on intellectual property charges paid by Australians to non-*

[41] Australian Taxation Office, 'Corporate Transparency Overview', September 2013, p. 10.
[42] Australian Taxation Office (2014), *ATO Annual Report 2013-14*, p. 59.
[43] Bruce Quigley, 'Tax administration in a global environment', Sydney, ATO Media Centre, 22 November 2012, https://www.ato.gov.au/Media-centre/Speeches/Other/Tax-administration-in-a-global-environment/
[44] Australian Government Treasury, 'Implications of the Modern Global Economy for the Taxation of Multinational Enterprises', Issues Paper, May 2013, pp. 7-8.
[45] Australian Government Treasury, 'Implications of the Modern Global Economy for the Taxation of Multinational Enterprises', Issues Paper, May 2013, pp. 11-14.

residents (that is, imports of intellectual property services). This data suggests that the amount paid is relatively small (just above ¼ per cent of GDP) and broadly constant as a share of GDP. On the other hand, ATO data on gross royalties paid to non-residents, derived from the annual non-resident interest, dividend and royalty form, suggests somewhat larger payments that are rising as a share of GDP over time.

The ATO has stated "some businesses take aggressive positions in contestable areas of the law. This includes tax-efficient structures and the characterisation and pricing of related-party transactions."[46] The ATO has further stated: "International risks account for over one-third of the issues in our work program and some of our largest compliance results relate to international tax issues."[47]

While there has been significant media attention on the alleged tax dodging activities of multinational technology companies, the ATO has publicly revealed concern about multinational corporate tax avoidance extending more widely. The Commissioner of Taxation stated in a speech:[48]

> *While large Multinational Enterprises (MNEs) in the digital space have had high profiles in the media, our compliance checks have indicated potential BEPS risks in a wide range of businesses such as small internet businesses and even brick and mortar businesses locating automated activities on offshore servers*.

In March 2013, the ATO revealed it had concerns about a significant proportion of large businesses:[49]

> *Of the biggest taxpayers in Australia looking at all Federal taxes:*
> - *6 (representing 1% of company tax) are seen as higher risk,*
> - *32 (representing 36% of company tax) are lesser risk but we have some areas of concern, and*
> - *54 (representing 37% of company tax) we currently have no significant concerns.*
>
> *Of the other large taxpayer groups:*
> - *Approximately 300 (representing 9% of company tax) we have concerns of a greater or lesser nature*
> - *Approximately 750 (representing 18% of company tax) we have no current concerns.*
>
> *So, numerically: its 340 companies (representing 45% of company tax) we have some level of concern about, and approximately 800 (representing 55% of company tax) we have no current concerns about.*

In December 2014, the Treasurer, The Hon Joe Hockey, has stated that the Australian Government was being short-changed by the cross-border profit shifting activities of MNEs to the tune of $1 billion to $3 billion a year.[50] Previously, in September 2014, the Commissioner

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[46] Australian Taxation Office (2014), *ATO Annual Report 2013-14*, p. 59.
[47] Australian Taxation Office (2014), *ATO Annual Report 2013-14*, p. 59.
[48] Chris Jordan, 'Commissioner's address to ICAA', ATO Media Centre, Melbourne, 12 June 2014, https://www.ato.gov.au/Media-centre/Speeches/Commissioner/Commissioner-s-speech-to-ICAA-Practice-Forum-2014/
[49] Mark Konza, 'Our compliance approach in the large market', Perth, ATO Media Centre, 13 March 2013, https://www.ato.gov.au/Media-centre/Speeches/Other/Our-compliance-approach-in-the-large-market/
[50] Heath Aston and Georgia Wilkins, 'Hockey stalls on promised Google tax', *The Age,* 10 December 2014.

of Taxation, Chris Jordan, said the ATO had estimated the government was losing up to $1 billion a year because of the tax minimising strategies of MNEs.[51]

The ATO revealed that in 2012–13, they raised assessments worth $169.6 million in tax and penalties from cross-border profit-shifting case work.[52] This was a significant increase on what the ATO had reported of adjustments of over $140m in additional tax, penalties and charges as a result of audits of international related party dealings in the period 2006 to 2010.[53] However, it needs to be noted that this amount will represent only a fraction of the profit shifting (tax dodging) activity taking place. It represents only the tax dodging activities where the ATO has detected the activity and where it thinks the activity is sufficiently in breach of Australian law that the ATO has a sufficient chance of upholding its ruling if challenged legally.

In November 2014, *The Australian* reported that among the top-200 listed companies at least $710 million is in dispute with the ATO as of the end of the financial year, according to research by corporate governance analysts Ownership Matters. Ownership Matters found 14 ASX200 companies involved in tax disputes in Australia and overseas. "with amounts under dispute running to tens, sometimes hundreds, of millions of dollars" and a further 11 companies that said they were under audit. The largest single dispute disclosed was a $203m amount claimed by the ATO over a sale and leaseback deal Bluescope Steel cut in 2007.[54]

In terms of litigation activity, there are relatively higher rates of disputes between the ATO and large businesses than other market segments, due to "the complexity of large commercial or international transactions, where there can be disagreement about how the law applies in the circumstances".[55] From July 1 to December 2012 the ATO conducted 230 active compliance activities (including audits, risk reviews, investigations and voluntary disclosure campaigns) with large and multinational businesses with 130 objection receipts.[56] Only 1% of tribunal litigation applications with the ATO concerned the large business or MNE market segment.[57] From July 1 to December 2012 there were a total of 77 cases involving large businesses, of which 10 went before the Full Federal Court with none in front of the High Court.[58] Large business taxpayers prefer to lodge appeals directly to the Federal Court, as litigation in the High Court occurs in only a very small number of cases, concentrating on issues of tax avoidance.[59] In anti-avoidance court cases between 2007 and 2012, 12 cases were favourable to the taxpayer and 8 favourable to the ATO.

The ATO has revealed in its annual report that it led a multilateral compliance approach with six other tax administrations to investigate global tax planning of multinational enterprises in

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[51] Georgia Wilkins, 'Tax take swims through tears in the corporate net', *The Age,* 6 September 2014.
[52] Australian Taxation Office, 'Commissioner of Taxation Annual Report 2012-13', 2013, p. 48.
[53] Bruce Quigley, 'Tax administration in a global environment', Sydney, ATO Media Centre, 22 November 2012, https://www.ato.gov.au/Media-centre/Speeches/Other/Tax-administration-in-a-global-environment/
[54] Ben Butler, 'ATO to target top tax divide', *The Australian*, 6 November 2014.
[55] Australian Taxation Office, 'Your case matters: Tax and superannuation litigation trends', 3rd ed. July 2007 - December 2012, pg. 7
[56] Australian Taxation Office, 'Your case matters: Tax and superannuation litigation trends', 3rd ed. July 2007 - December 2012, pg. 6
[57] Australian Taxation Office, 'Your case matters: Tax and superannuation litigation trends', 3rd ed. July 2007 - December 2012, pg. 19
[58] Australian Taxation Office, 'Your case matters: Tax and superannuation litigation trends', 3rd ed. July 2007 - December 2012, pg. 16
[59] Australian Taxation Office, 'Litigation Statistics: Court Litigation', ato.gov.au, https://www.ato.gov.au/General/Correct-a-mistake-or-dispute-a-decision/In-detail/Statistics/Litigation-statistics/Court-litigation/

the digital economy. This work produced an aggregated risk report which merged information from each jurisdiction on global e-commerce business structures, tax risks, and patterns and trends in the digital economy. Building on this knowledge, the group identified the specific global tax planning arrangements of a handful of taxpayers, which the group can use to examine compliance with the existing law. Work is currently underway to undertake joint compliance action on a number of these multinationals."[60]

More recently, Commissioner of Taxation, Chris Jordan, was quoted in the media as stating that the ATO's International Structuring and Profit Shifting initiative was expected to raise over $1 billion in additional revenue over the next three years, and had already raised an additional $204 million in liabilities.[61] He stated "We started the year with 86 cases selected for review across a range of industries. We have now completed 30 reviews, 10 involving tech companies. Further reviews have commenced and we expect 70 to 80 reviews will form part of our on-going program of work. We expect to commence around 10 audits where we have identified a number of concerns."[62] Deputy Commissioner Mark Konza had previously said that a small portion of the 86 high-risk cases were using "hubs" in low-tax nations such as Singapore and Ireland to avoid paying tax here.[63] However, again, it needs to be noted that these activities represents only the tax dodging activities where the ATO has detected the activity and where it thinks the activity is sufficiently in breach of Australian law that the ATO has a sufficient chance of upholding its ruling if challenged legally.

In January 2015, the ATO stated:[64]

> *We have commenced more than 200 client risk reviews on multinational companies, including 25 tech companies or companies that conduct a significant portion of their business digitally. We have completed approximately 50% of the reviews and have commenced 20 audits where we have identified significant concerns.*

The Commissioner of Taxation has stated that the ATO is investigating:[65]

- business restructures like digital duplication of domestic business to shift profits to a low tax jurisdiction;
- IT companies with low domestic tax and large 'stateless income';
- pricing mismatches, with large mark-ups ending up in an offshore 'services' hub;

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[60] Australian Taxation Office (2014), *ATO Annual Report 2013-14*, p. 28.
[61] Daniel Hurst, 'Joe Hockey announces profit-shifting tax audit of 10 multinationals', *The Guardian*, 9 December 2014.
[62] Daniel Hurst, 'Joe Hockey announces profit-shifting tax audit of 10 multinationals', *The Guardian*, 9 December 2014.
[63] Nassim Khadem, 'Profit shifting not just a tech problem: ATO', *The Australian Financial Review,* 21 May 2014.
[64] Andrew Mills, 'It's time for tax (administration) reform', Speech, Adelaide, ATO: Media Centre, 20 January 2015, https://www.ato.gov.au/Media-centre/Speeches/Other/It-s-time-for-tax-(administration)-reform/
[65] Chris Jordan, 'Commissioner's address to ICAA', Melbourne, ATO Media Centre 12 June 2014, https://www.ato.gov.au/Media-centre/Speeches/Commissioner/Commissioner-s-speech-to-ICAA-Practice-Forum-2014/; Chris Jordan, 'Reinventing the ATO – building trust in Australia's tax administration', Sydney, ATO Media Centre, 14 April 2014, https://www.ato.gov.au/Media-centre/Speeches/Commissioner/Reinventing-the-ATO---building-trust-in-Australia-s-tax-administration/; Andrew Mills, 'I've looked at tax from both sides now', ATO Media Centre, Melbourne, 10 October 2014, https://www.ato.gov.au/Media-centre/Speeches/Other/I-ve-looked-at-tax-from-both-sides-now/; Mark Konza, 'Base erosion and profit shifting – a progress report on G20/OECD action', Melbourne, ATO Media Centre, 25 September 2014, https://www.ato.gov.au/Media-centre/Speeches/Other/BEPS---a-progress-report-on-G20/OECD-action/; and Mark Konza, 'Base erosion and profit shifting', Sydney, ATO Media Centre, 26 November 2013, https://www.ato.gov.au/Media-centre/Speeches/Other/Base-erosion-and-profit-shifting/?page=1#Footnotes

- manipulating company or subsidiary residency to create stateless income;
- tax arbitrage via hybrid entities/instruments;
- treaty abuse;
- the alienation of intangibles at 'non arms-length' prices; and
- debt dumping into Australia, sometimes involving inflated asset valuations to provide a façade of compliance with thin capitalisation safe harbours.

Treasury noted in May 2013 there was a need for reform to address artificial debt loading by multinational enterprises:[66]

> *The Commissioner of Taxation has observed some aggressive tax structures that seek to take advantage of the generosity of the current rules and allows profits to be shifted through excessive debt allocations. The structure involves exploiting a combination of the current thin capitalization settings, an inconsistency in the law to not impede Australian firms investing overseas and a measure that was intended only to reduce compliance costs. It is now clear that these provisions are being abused as part of a profit shifting strategy that results in no significant change to economic activity in Australia.*

It remains to be seen the level of impact the small changes made subsequently to Australia's thin capitalisation rules will have on artificial debt loading strategies adopted by multinational enterprises operating in Australia.

In May 2014, Deputy Commissioner Mark Konza was quoted in the press as stating that some multinationals were paying related companies 900 per cent returns to avoid paying tax in Australia.[67] "The problem is that some companies, when they go to all the effort of setting up a hub, they can't help but ratchet it up to almost a ridiculous level sometimes," Mr Konza said. "We've seem returns of 900 per cent for examples, on the activities in some hubs. There's no way you'd pay a third-party 900 per cent return to do the same function that you were already doing."[68]

The ATO reported that the 2,168 entities identified as reporting more than $100 million in total annual income and thus requiring disclosure of their tax information under the new *Tax Laws Amendment Act* ('the Corporate Transparency Population' or 'CTP') had $271 billion in related party borrowings (interest free and interest bearing) between them which accounted for 26% of their total debt in 2012.[69] The BFS and energy and resources entities accounted for over 70% of the total related party borrowings.[70] The related party borrowings to total debt ratio for the three industry sectors have been relatively stable throughout 2006 to 2012.[71] The BFS sector had the largest value of international related party borrowings (interest bearing and interest free) which are concentrated across fewer entities (five to six entities), and related party borrowings to total debt is 9% for the sector.[72] This ratio is 30% for energy and resources corporations reflecting a higher dependence on related party funding for Australian resource investments.[73]

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[66] The Australian Government Treasury, 'Addressing profit shifting through the artificial loading of debt in Australia', 14 May 2013, p. 1.
[67] Nassim Khadem, 'Profit shifting not just a tech problem: ATO', *The Australian Financial Review,* 21 May 2014.
[68] Nassim Khadem, 'Profit shifting not just a tech problem: ATO', *The Australian Financial Review,* 21 May 2014.
[69] Australian Taxation Office, 'Corporate Transparency Overview', September 2013, p. 1.
[70] Australian Taxation Office, 'Corporate Transparency Overview', September 2013, p. 10.
[71] Australian Taxation Office, 'Corporate Transparency Overview', September 2013, p. 10.
[72] Australian Taxation Office, 'Corporate Transparency Overview', September 2013, p. 10.
[73] Australian Taxation Office, 'Corporate Transparency Overview', September 2013, p. 10.

Of the CTP, 700 entities lodged a thin capitalisation schedule or International Dealings Schedule for the 2012 financial year.[74] Of the general investor entities, 15% (91) had a financing structure that was above the 60% proposed safe harbour announced by the previous Government.[75] Of the financial and authorised deposit taking institutions, 22% (11) had a financing structure that was near or exceeding the current safe harbour limit of 95% debt to assets ratio.[76] The ATO pointed out that "Revaluations and internally generated goodwill are included in asset values for thin capitalisation purposes which can reduce gearing to below safe harbour".[77]

In the presentation to the Victorian Tax Institute the ATO revealed that International Dealing Schedules (IDS) submitted by businesses showed that around $10 billion was paid on debts of $234 billlion in 2012, at an average interest rate of 4.39%. In the same year, around $5 billion of interest payments were made to Australian entities from overseas on loans of $160 billion, with an average interest rate of 3.24%.[78] The ATO asked "Why would Australian entities make loans to foreign related parties at 3.25% when they can get more than that with secure investments in Australia?"[79] The obvious answer is for the purposes of tax avoidance, although the ATO acknowledged that different currencies and terms could explain part of the difference. The ATO pointed out these loans "could be viewed as revenue leakage of $1.8b".[80] The ATO also asked the rhetoric question "Australia has maintained relatively high interest rates compared to other developed countries, so why lend overseas for less? – as is suggested by the IDS values."[81]

In October 2014 the ATO revealed it was examining the energy and resources area for evidence of tax avoidance across a range of activities:[82]

> *The first of these, transfer pricing, includes: cross border restructuring and financing; offshore hubs (in particular marketing and procurement); inbound and outbound technical services; and freight charges and commodity pricing.*
>
> *We are looking closely at permanent establishments – the use and payment for plant and equipment including oil rigs, transfer pricing and restructuring activities (Australian source and Part IVA issues).*
>
> *Mergers, acquisitions and divestments – the interaction between various tax provisions – is an ongoing focus, as is losses, the continuity of ownership, same business or recoupment tests.*
>
> *Thin capitalisation – the proposed new safe harbour threshold, arm's length debt rules and asset revaluations – is a key area.*
>
> *Beyond these areas, we are looking particularly closely at several issues including the use of complex domestic and international corporate structures and 'innovative' financing arrangements.*

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[74] Australian Taxation Office, 'Corporate Transparency Overview', September 2013, p. 11.
[75] Australian Taxation Office, 'Corporate Transparency Overview', September 2013, p. 11.
[76] Australian Taxation Office, 'Corporate Transparency Overview', September 2013, p. 11.
[77] Australian Taxation Office, 'Corporate Transparency Overview', September 2013, p. 11.
[78] Australian Taxation Office, Presentation to the Tax Institute, 2014.
[79] Australian Taxation Office, Presentation to the Tax Institute, 2014.
[80] Australian Taxation Office, Presentation to the Tax Institute, 2014.
[81] Australian Taxation Office, Presentation to the Tax Institute, 2014.
[82] Mills, A., 'Reinventing Law Design and Practice within the ATO', Perth, ATO Media Centre, 16 October 2014, https://www.ato.gov.au/Media-centre/Speeches/Other/Reinventing-Law-Design-and-Practice-within-the-ATO/

We are examining the economic versus tax performance of sub-industries such as utilities and petroleum. Specifically, we are seeking to understand:

- *any variations in the amounts or patterns of tax payments compared to past performance, relevant economic indicators and industry trends;*
- *variations between economic performance, productivity and tax performance;*
- *losses, low effective tax rates, and cases where a business or entity consistently pays relatively little or no tax; and*
- *adequacy of transfer pricing documentation following new legislation, rulings and guidelines.*

The ATO has stated that in terms of the use of secrecy jurisdictions:[83]

Foreign and Australian based MNEs use offshore arrangements to inappropriately transfer profits from Australia to related offshore party hubs which:

- *Centralise functions and associated risks in an entity in a low tax jurisdiction where: a high value is attributed to the function; or the risks have been legally assigned to, but not fully assumed by the entity; or the entity has little or no ability to control these risks.*
- *Involve the related entity in the low tax jurisdiction purporting to provide such value add activities to the Australian taxpayer for a significant fee which does not result in outcomes expected or observed between arm's length parties.*
- *Result in profit in Australia not being taxed, or the exclusion of profits that were previously taxed in Australia, where this is not commensurate to the level of economic activity that takes place in Australia.*
- *Where the transfer of function or risks is involved, the transfer does not appear to have a commercial justification, or does not appear to be to the benefit of the Australian taxpayer.*

In terms of the amount of tax revenue at risk from the use of secrecy jurisdictions, the ATO believes:[84]

Based on review and audit activity on 15 marketing hub cases as at December 2012, the tax at risk was estimated at $680 million (net tax). This estimate was reported to be subject to change as some positions were not accepted by the taxpayers involved and some amounts were contested. Overall, the profit shifting risk, registered on Enterprise Risk Manager, has a current rating of 'high' with an estimated consequence range of $10.8 to $12.1 billion.

In terms of the drivers of risk, the ATO has assessed:[85]

Participants in creating, facilitating and exploiting this risk are either primary (directly involved) or secondary (indirectly involved) risk participants, depending on their roles. These participants range from MNEs to tax agents/advisors and foreign governments.

Typically large MNEs have the resources and sophistication to implement robust and technically defensible offshore hubs structures compared to SMEs.

The risk drivers differ among the participants involved. They include, but are not limited to:

- *MNEs maximising their global profits via a reduction in their global effective tax rate.*
- *MNEs and domestic entities duplicating the arrangements of first movers out of economic imperative, in order to remain competitive within their industry.*

[83] Australian Taxation Office, 'Offshore hubs mitigation strategy overview', 17 July 2014, p. 4.
[84] Australian Taxation Office, 'Offshore hubs mitigation strategy overview', 17 July 2014, p. 4.
[85] Australian Taxation Office, 'Offshore hubs mitigation strategy overview', 17 July 2014, pp. 4-5.

- *Profit generation by advisory firms.*
- *Foreign governments offering tax holidays and incentives to promote the movement of certain business functions to their country (e.g. the Economic Development Board in Singapore).*

The ATO's assessment of the tax issues raised by MNEs use of secrecy jurisdictions are:[86]

> *The ATO considers that the use of offshore hubs may give rise to tax issues around the:*
>
> - *Application of Division 815 of the Income Tax Assessment Act 1997 (ITAA 1997) to the arrangement, or the application of the former Division 13 of ITAA 1936 for particular earlier tax years*
> - *Application of a relevant international tax agreement to the arrangement (particularly the Associated Enterprises Article of Australian Double Tax Agreements)*
> - *The value attributed to the transfer of tangible and intangible assets to international related parties and application of an appropriate pricing methodology*
> - *Whether the international related party dealings create a "permanent establishment"*
> - *Application of the Controlled Foreign Company (CFC) provisions (of Part X of the ITAA 1936) to attribute the income of the non-resident to an Australian resident taxpayer*
> - *Application of the CGT provisions on the disposal or transfer of assets to the offshore entity*
> - *Application of royalty withholding tax on payments to the offshore entity*
> - *Application of other provisions of the income tax law, including the general anti avoidance provisions (Part IVA of ITAA 1936), where applicable.*

In terms of the action the ATO has taken in response to MNEs using subsidiaries in secrecy jurisdictions:[87]

> *Under the ISAPS [International Structuring and Profit Shifting] initiative, the profit shifting risk models have led to the creation of over:*
>
> - *50 cases with restructuring issues; and*
> - *100 cases with profit shifting issues that can include pricing issues in relation to the use of offshore hubs.*
>
> *There are also an additional 20 cases under review, audit or APA [Advance Pricing Agreement] negotiations with known marketing or procurement hub issues. While initial intelligence from these cases indicates that we are still seeing the implementation and use of marketing hubs, there is also evidence of the use of procurement, logistics/shipping, intellectual property and financial hubs respectively. Intelligence also indicates that individual MNEs may have more than one hub structure in operation.*

The ATO has indicated that Australia's general anti-avoidance rule, Part IVA, is not likely to be effective in combating MNEs engaged in tax avoidance activities through the use of subsidiaries in secrecy jurisdictions:[88]

> *In most cases the business (re)structure is business initiated and driven. Intelligence from compliance activity indicates that Part IVA is likely to be ineffective in many cases. However, there will be cases involving how the hub is structured, or where the particular critical step in the restructure cannot be explicable by non-tax commercial reasons, where the structure will be susceptible to challenge under Part IVA.*

[86] Australian Taxation Office, 'Offshore hubs mitigation strategy overview', 17 July 2014, p. 5.
[87] Australian Taxation Office, 'Offshore hubs mitigation strategy overview', 17 July 2014, pp. 6-7.
[88] Australian Taxation Office, 'Offshore hubs mitigation strategy overview', 17 July 2014, pp. 7-8.

The ATO has acknowledged that Australia's bilateral tax treaties can at times be misused to facilitate tax avoidance:[89]

> *Australia has 44 bilateral tax treaties with our international treaty partners. The main purpose of tax treaties is to facilitate cross-border trade and investment by preventing double taxation. However, there are some circumstances where the benefits provided by treaties can result in unintended double non-taxation.*

In May 2013, the ATO revealed they had substantial data which reveals extensive use of complex offshore structures to conceal assets by wealthy individuals and companies. The data reveals complex offshore structures in a number of jurisdictions around the world including Singapore, British Virgin Islands, Cayman Islands and Cook Islands.[90] The ATO stated: "There is nothing illegal about an international structure, especially in a globally integrated economy. However, offshore structures are often used for false loans, inflated tax deductions, hiding assets and other arrangements to avoid or evade tax liabilities."[91]

The ATO stated publicly in November 2014 that "We notice that the appetite for taking on tax risk – i.e. the risk of the ATO taking a different view to them, is currently decreasing if anything".[92] This would appear to be good news, that the public and international attention to cross-border tax dodging by MNEs may be having an impact on the tax risk-taking behaviour of MNEs.

The Treasurer revealed in December 2014 that there were 60 ATO auditors "embedded" in the offices of 10 MNEs to ascertain if those corporations were compliant with Australian tax law.[93]

The ATO has been willing to enter advance pricing arrangements where companies who wish to agree, in advance, the basis for pricing their cross-border related-party transactions. As at 30 June 2014, there were 175 advance pricing arrangements in place, which include 35 advance pricing arrangements that were completed during the income year. These applications may also be on a bilateral basis involving overseas tax administrations.[94] As of November 2014, the ATO revealed there were a further 59 Advance Pricing Agreements "under negotiation", meaning companies with cross-border transactions had requested one but the ATO had not yet agreed to it.[95] Between 2006 and 2010 around $40 billion of International Related Party Dealings were covered by Advance Pricing Agreements.[96] Concerns have been raised in the media from unnamed sources that the APA Unit within the ATO had become too close to accounting firms such as PricewaterhouseCoopers.[97] Further,

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[89] Mark Konza, 'Base erosion and profit shifting – a progress report on G20/OECD action', Melbourne, ATO Media Centre, 25 September 2014, https://www.ato.gov.au/Media-centre/Speeches/Other/BEPS---a-progress-report-on-G20/OECD-action/.

[90] Australian Taxation Office, 'No safe havens', ATO Media Centre, 10 May 2013, https://www.ato.gov.au/Media-centre/Media-releases/No-safe-havens/

[91] Australian Taxation Office, 'No safe havens', ATO Media Centre, 10 May 2013, https://www.ato.gov.au/Media-centre/Media-releases/No-safe-havens/

[92] George Hitti, Assistant Deputy Commissioner, Public Groups and International, ATO, 'Speech to the Institute of Public Accountants', Hunter Valley, ATO Media Centre, 28 November 2014.

[93] Heath Aston and Georgia Wilkins, 'Hockey stalls on promised Google tax', *The Age,* 10 December 2014.

[94] Australian Taxation Office (2014), *ATO Annual Report 2013-14*, p. 60.

[95] Nassim Khadem, 'Furious ATO cancels big firms' deals', *The Age,* 7 November 2014, p. 10.

[96] Bruce Quigley, 'Tax administration in a global environment', Sydney, ATO Media Centre, 22 November 2012, https://www.ato.gov.au/Media-centre/Speeches/Other/Tax-administration-in-a-global-environment/

[97] Chenoweth, N., 'PwC Lux deals, ATO advice', *The Australian Financial Review,* 13 November 2014, p. 5.

the APA Unit had failed to detect changes in the underlying business arrangements described in the APAs when they are rolled over for extension.[98]

In early November 2014, it was reported that Chris Jordan had instructed ATO staff "to make sure that APAs were not issued on high risk tax planning arrangements."[99] In September 2014, it had been reported in the media that Commissioner Chris Jordan has suspended all further rollovers of tech company APAs while the ATO e-commerce investigation into tax avoidance continued.[100]

Information provided under FOI by the ATO reported that the ATO has declined/deferred nine APA applications consisting of:[101]

- *2 BEPS audits [redacted]*
- *4 referrals to ISAPS teams for follow ups [redacted]*
- *2 awaiting outcome of other audit activity before proceeding with APA renewal*
- *1 where taxpayer was unable to provide adequate documentation over a prolonged period of time*
- *1 taxpayer withdrew from the process, with no other ATO action undertaken*

The ATO stated the reasons for declining or deferring the APAs were:[102]

- *Tax issues arising from the digital economy*
- *Profit attribution question on which we are still settling the ATO view*
- *Taxpayers failing to provide appropriate documentation over a long period of time*
- *Taxpayer had previously failed to comply with the APA conditions; such as the requirement of an annual report confirming the facts/critical assumptions remain relevant.*

AUSTRAC analysis of fund movements to and from selected secrecy jurisdictions found that in 2012-13 $60 billion flowed into Australia from secrecy jurisdictions, while $47 billion flowed out of Australia.[103] AUSTRAC figures for 2012–13 show less money was sent from Australia to overseas tax secrecy jurisdictions such as Vanuatu, Liechtenstein and Jersey than was sent five years ago.[104]

The Australian Financial Review reported that Australian companies sent almost $60 billion to related parties in tax havens in 2012. Asia was the place of choice for offshore hubs, with almost $40 billion being sent to Singapore. And more than $7.5 billion was channelled through subsidiaries in Ireland.[105]

The ATO uses AUSTRAC information to identify suspected tax avoidance, including abuse of overseas tax and secrecy havens. During 2013–14 AUSTRAC information contributed to 20,931 ATO cases resulting in $358.3 million in tax assessments raised.[106] It is not clear how

[98] Chenoweth, N., 'PwC Lux deals, ATO advice', The Australian Financial Review, 13 November 2014, p. 5.
[99] Nassim Khadem, 'ATO revokes multinationals' tax deals', *The Australian Financial Review,* 7 November 2014, p. 11.
[100] Neil Chenoweth, 'Structural Shenanigans of tech companies attract Tax Office ire', *The Australian Financial Review*, 27-28 September 2014.
[101] Australian Taxation Office, 'APA Background Figures', undated briefing paper
[102] Australian Taxation Office, 'APA Background Figures', undated briefing paper
[103] Australian Taxation Office (2014), *ATO Annual Report 2013-14*, p. 61.
[104] AUSTRAC (2014*), AUSTRAC Annual Report 2013-14,* p. 63.
[105] Nassim Khadem, 'Profit shifting not just a tech problem: ATO', *The Australian Financial Review,* 21 May 2014.
[106] AUSTRAC (2014), *AUSTRAC Annual Report 2013-14*, p. 74.

much of this resulted from cases involving individuals and how much involved multinational enterprises.

There are some examples of academic work indicating that MNEs operating in Australia are engaged in profit shifting. 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 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.[107]

Work by Taylor and Richardson found that for publicly listed Australian companies thin capitalisation and transfer mispricing were the primary methods of tax avoidance in the period 2006 to 2009.[108] However, communication with Professor Rick Krever from the Department of Business Law and Taxation at Monash University points to the limitations of such work, due to the level of confidentiality that applies to the tax affairs of MNEs. As Professor Krever points out "In the absence of any actual data, Taylor and Richardson in effect tried to recreate the level of transfer pricing and offshore arrangements by looking at surrogate measurements, assuming there will be a correlation between different factors and the level of international income shifting." Thus, as with all regression analysis, assumptions must be made and the analysis is then made on the basis of the assumptions. Professor Krever went on to point out "the problem is that the underlying assumptions are pure guesses. We truly have no data to develop what we know are accurate assumptions. If we had that data, we wouldn't need to do the regression analysis to reconstruct the levels of avoidance – we'd simply add up the numbers." This is not critique of Taylor and Richardson's work, it simply points to the limitations imposed on all analysis of the level of profit shifting by MNEs in Australia due to the level of confidentiality provided to them by Australian law.

Professor Krever stated the only way to accurately estimate the level of profit shifting that is occurring:

> *is to adopt the formula used in formula apportionment systems and measure the relative sales to final consumers (unrelated parties), the payroll costs, and the tangible capital costs in each country and divide total world income using the formula. Once you've done that, you'll see how much income should have been reported in Australia. But once you've done that, you might as well tax using a formula apportionment system rather than the water's edge or arm's length fictions we now use and the problem goes away.*

Taylor and Richardson (2013) investigated the determinants of thinly capitalised structures of publicly-listed Australian firms. They used regression analysis of a sample of 203 publicly-listed Australian companies over the period 2006-2009.[109] Based on the magnitude and significance levels of the regression coefficients in their study, variables pertaining to

107 David McNair and Andrew Hogg, 'False profits: robbing the poor to keep the rich tax-free', Christian Aid, March 2009. pp.20, 27.

108 Grantley Taylor and Grant Richardson, "International Corporate tax Avoidance Practices: Evidence from Australian Firms", The International Journal of Accounting **47**, (2012), p. 491.

109 Grantley Taylor and Grant Richardson, 'The determinants of thinly capitalised tax avoidance structures: evidence from Australian firms', *Journal of International Accounting, Auditing and Taxation*, **22** (2013), p. 12.

multinationality and tax haven utilisation were, in particular, significantly and positively associated with firms' thin capitalisation position. They also presented supplementary evidence which showed that corporate governance monitoring mechanisms relating to board of director independence, institutional ownership and 'Big-4' auditor employment were significantly negatively associated with firms' thinly capitalised position.[110]

Richardson, Taylor and Lanis (2013) used regression analysis to examine the major determinants of transfer pricing aggressiveness by Australian companies. Based on a sample of 183 publicly listed Australian firms for the 2009 year, their results showed that firm size, profitability, leverage, intangible assets, and multinationality were significantly positively associated with transfer pricing aggressiveness after controlling for industry-sector effects. Their additional regression results also indicated that firms augment their transfer pricing aggressiveness through the joint effect of intangible assets and multinationality.[111]

Taylor *et al* (2014) used a sample of 200 publicly listed Australian firms over the 2006-2010 period, to examine the major determinants of tax haven utilisation by publicly listed Australian firms. Their regression results show that variables pertaining to transfer pricing, intangible assets, an interaction term between the two, withholding taxes, performance-based management remuneration, and multinationality are positively associated with tax haven utilisation. They also observed that corporate governance structures are negatively associated with tax haven utilisation.[112]

Work by Karkinsky and Riedel that examined European based MNEs found that the number of patents registered in a jurisdiction reduced with the tax rate for that jurisdiction. The effect prevails when they accounted for the role of withholding taxes on royalty payments and CFC legislations.[113] They concluded that MNEs do distort the location of their corporate patents in favour of low-tax affiliates. Further:[114]

> *As patented technologies are considered to be drivers of future profits and simultaneously constitute a major source of transfer pricing opportunities within multinational groups, their relocations are likely to shift relevant volumes of profit to low-tax economies. Consequently, governments have an incentive to compete for these mobile profits by reducing their corporate tax rates in order to attract multinational patents to their jurisdiction.*

A trend of shifting patent location over time to secrecy jurisdiction may be an indicator of increased likelihood of profit shifting activities based on royalty payments. However, this measure is only likely to be a very small part of any profit shifting activities taking place out of Australia.

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[110] Grantley Taylor and Grant Richardson, 'The determinants of thinly capitalised tax avoidance structures: evidence from Australian firms', *Journal of International Accounting, Auditing and Taxation*, **22** (2013), p. 23.

[111] Grant Richardson, Grantley Taylor and Roman Lanis, 'Determinants of transfer pricing aggressiveness: Empirical evidence from Australian firms', *Journal of Contemporary Accounting & Economics* **9** (2013) p. 136.

[112] Grantley Taylor, Grant Richardson and Ross Taplin, 'Determinants of tax haven utilization: evidence from Australia firms', *Accounting and Finance Association of Australia and New Zealand*, 2014, pp. 1-3.

[113] Tom Karkinsky and Nadine Riedel, 'Corporate taxation and the choice of patent location within multinational firms', J. International Economics, 88 (2012), p. 185.

[114] Tom Karkinsky and Nadine Riedel, 'Corporate taxation and the choice of patent location within multinational firms', J. International Economics, 88 (2012), p. 185.

In November 2012, the ATO revealed:[115]

> *In a recent transfer pricing audit, we examined a multinational enterprise claiming deductions for very large amounts of royalty and service fees. Our initial enquiries to the taxpayer revealed that they had transferred intellectual property to the Netherlands for several billion dollars and this was the source of the large deduction.*
>
> *When we asked about the treatment of the intellectual property by the parts of the group operating in other jurisdictions, we were assured the treatment was consistent across jurisdictions. As it turned out, following an Exchange of Information request with the US, UK and Netherlands, this transfer value was not in accordance with a cost sharing agreement in another jurisdiction and, as a result, we are challenging this inconsistency.*

However, in the same document released under FOI, the ATO also talks about seven out of nine taxpayers who made disclosures [through RTPSs] were Quadrant 2 [key intermediaries] (and therefore two taxpayers were Quadrant 1 [higher risk intermediaries]). They stated:[116]

> *Minimal information was provided in the content of the disclosures by the Quadrant 1 taxpayers, albeit in the case of [redacted] they made many disclosures. However [redacted] made detailed disclosures on industry issues that were well known and were irritants to [redacted]. The remaining disclosures made were very short and did not meet truly the instructions for the disclosure requirements, but the Ops team is confident they know about each disclosure.*

Documents obtained under FOI from the ATO indicated that in the 2013 income year a total of 168 entities were notified of their requirement to lodge a RTPS. Of those 158 (94%) lodged their RTPS and 10 (6%) failed to do so.[117] A total of 24 RTPS' disclosed entities, totalling 45 entities, of which 16 (36%) were Category A.[118] Category A is a position that is about as likely to be correct as incorrect, or is less likely to be correct than incorrect.

Of the 24 entities that made disclosures, 22 entities discussed other positions with the case team that were not disclosed on the RTPS.[119] Further, 21 entities (88%) discussed other potential Reportable Tax Positions (RTPs), but it was determined that those positions did not meet either the materiality threshold or RTP definitions.[120]

The ATO stated "This implies that the accuracy of the RTPS is heavily dependent upon the case teams' understanding the materiality threshold and RTP definitions. A weakness in the

[115] Bruce Quigley, 'Tax administration in a global environment', Sydney, ATO Media Centre, 22 November 2012, https://www.ato.gov.au/Media-centre/Speeches/Other/Tax-administration-in-a-global-environment/

[116] ATO document 8 of material provided under FOI to the Synod of Victoria and Tasmania, Uniting Church in Australia, '2012 RTPS (Reportable Tax Position Schedule) report overview', undated.

[117] ATO Document 9 of material provided under FOI to the Synod of Victoria and Tasmania, Uniting Church in Australia, 'Reportable tax position schedule analysis report (2012-13 income year)', 23 October 2014.

[118] ATO Document 9 of material provided under FOI to the Synod of Victoria and Tasmania, Uniting Church in Australia, 'Reportable tax position schedule analysis report (2012-13 income year)', 23 October 2014.

[119] ATO Document 9 of material provided under FOI to the Synod of Victoria and Tasmania, Uniting Church in Australia, 'Reportable tax position schedule analysis report (2012-13 income year)', 23 October 2014.

[120] ATO Document 9 of material provided under FOI to the Synod of Victoria and Tasmania, Uniting Church in Australia, 'Reportable tax position schedule analysis report (2012-13 income year)', 23 October 2014.

case teams' knowledge of this criterion would result in the RTPS not capturing all required RTPs."[121]

Again to emphasise the risk of tax avoidance by MNEs is not limited to foreign technology MNEs, the ATO stated that the entities that made disclosures were dispersed across various industries:[122]

- nine within banking, finance and insurance;
- eight within energy and resources and manufacturing; and
- seven within media and entertainment, communications and retail consumable goods.

Of the 45 entities disclosed:[123]

- 13 disclosures related to Capital Gains Tax (CGT) and Consolidation (768-G – capital gains reduced from foreign asset sales, other CGT events, calculation of consolidation entries and exits);
- Six disclosures relate to transfer pricing (range of issues including intellectual property, royalties, provision of services, marketing, and losses between related parties); and
- The remainder were a mixture of domestic and international related issues (research and development/exploration, foreign income 23AH, interpretation of thin capitalisation deductions).

Of the 10 entities that did not lodge RTPS', eight had reasons, and two provided no reasons.[124] One of those two advised the case team that it does not intend to lodge its 2013 RTPS; the other had not responded to the case team enquiry.[125]

34.3. Case Studies of Particular Companies

34.3.1. Glencore Case Study

Glencore Plc, is incorporated in the UK, listed on the London and other Stock Exchanges, with its registered office in Jersey and its head office is in Baar, Switzerland.

Glencore's investments in Australia cover a range of market segments. To avoid unnecessary complexity, it was decided to limit the case study of Glencore's activity in Australia to its coal investments. Given its Australian coal interests are fragmented and controlled through a number of holding company arrangements, the study was further limited to AZSA Holdings Pty Limited (AZSA) and its principle wholly owned subsidiary in Australia, Glencore Coal Investments Australia Pty Limited (GCIA).

This case study is primarily based on AZSA and GCIA's Financial Statements from the 2012 and earlier years. While GCIA produced special purpose consolidated financial statements

[121] ATO Document 9 of material provided under FOI to the Synod of Victoria and Tasmania, Uniting Church in Australia, 'Reportable tax position schedule analysis report (2012-13 income year)', 23 October 2014.
[122] ATO Document 9 of material provided under FOI to the Synod of Victoria and Tasmania, Uniting Church in Australia, 'Reportable tax position schedule analysis report (2012-13 income year)', 23 October 2014.
[123] ATO Document 9 of material provided under FOI to the Synod of Victoria and Tasmania, Uniting Church in Australia, 'Reportable tax position schedule analysis report (2012-13 income year)', 23 October 2014.
[124] ATO Document 9 of material provided under FOI to the Synod of Victoria and Tasmania, Uniting Church in Australia, 'Reportable tax position schedule analysis report (2012-13 income year)', 23 October 2014.
[125] ATO Document 9 of material provided under FOI to the Synod of Victoria and Tasmania, Uniting Church in Australia, 'Reportable tax position schedule analysis report (2012-13 income year)', 23 October 2014.

for 2013, with less information than in previous years, AZSA stopped producing consolidated financial statements at that point.

Jeffrey Knapp, an accounting lecturer from UNSW, has reviewed Glencore's accounts and sat in on a meeting between the company and Fairfax. Knapp told *Crikey* it was impossible to confirm how much tax Glencore had in fact paid on its Australian coal business in the last three years using publicly available information.[126]

From around 2006, Glencore Plc controlled approximately 40% of Xstrata stock. It is reported to have acted as Xstrata's marketing partner and was able to appoint Xstrata's CEO. Glencore's merger with Xstrata Plc became effective on 2 May 2013 at which point Glencore owned all the issued shares in Xstrata. The merger had effectively been approved on 20 November 2012 by shareholder vote, but was conditional on Chinese regulatory approval.

As at 31 December 2012 a majority of Glencore's Australian coal investments were subsidiaries of GCIA. GCIA's immediate Holding company incorporated in Australia is Glencore Coal Holdings Pty Ltd (GCH). The immediate parent of GCH is AZSA Pty Limited, also incorporated in Australia.

In addition to its investment in GCIA, AZSA had five additional Australian incorporated subsidiaries associated with GCIA's investments. AZSA's other investments at the time were nine subsidiaries incorporated in Canada. As at 31 December 2012, these additional AZSA companies had produced little in the way of change to information disclosed in GCIA's financial statements. For the purposes of discussing the Group's Australian financial statements and Income Tax obligations there is little point in distinguishing the two companies.

From the 2013 Financial Statements of AZSA's ultimate parent, Glencore Plc, its $12.5 billion value of goodwill generated by the Xstrata acquisition was allocated as $5 billion as to marketing operations and $7.5 billion to mining operations (which includes metals and coal operations in Australia). The allocation "…was based on the value of expected margin synergies to be realised by the Group's existing marketing operations as a result of increased product flows from Xstrata ..."[127] Puzzlingly, Glencore had no coal marketing companies incorporated in Australia at the time.

While Xstrata itself was a multinational with a globalised governance structure, it still ran its investments as separate body corporates grouped in divisions such as Copper, Coal and Nickel. GCIA and its subsidiaries marketed their own coal, sometimes with the assistance of Glencore for which they paid marketing commissions at arms-length rates. The head office of the coal division was located in Sydney and maintained separately from Xstrata's other investments.

Under Glencore Plc's control, it would appear its global governance structure has been rolled out into its Australian investments and effectively replaces the traditional governance structure under which the staff of local companies reported to their board. Under the revised arrangements, Australian staff have global titles and appear to report along global lines of authority. It appears to us that some no longer have any direct reporting line to local directors.

[126] Paddy Manning, 'Murky accounts and obfuscation keep Glencore's tax bill well hidden', *Crikey.com*, 22 October 2014.
[127] 2013 Financial Statements, Note 5 Impairments

Following establishment of the Singapore companies, Glencore directed its Australian subsidiaries to sell coal to them, such that AZSA/GCIA's sales to related parties had increased from 8% of total in 2008 to 46% by end 2013. In the short time since their incorporation, profits reported by the Singapore trading companies (the ones we were able to identify and obtain returns for) had exceeded $200 million.

There is insufficient information in the returns to determine whether or not current assets include inventory or were predominately limited to receivables from end customers. It is assumed non-current assets consist solely of contractual rights as we don't have access to the related party contracts to determine where and when property in the coal passes. The balance sheet suggests the related contracts were back to back with the contracts with third parties. However, a lack of physical assets in Singapore would be a strong indication that the business is really carried on in Switzerland which is also the place of central management and control for these companies. They may therefore have dual residency in Singapore (due to incorporation) and Switzerland.

Of further concern is the statements made by Glencore regarding synergies that the acquisition was expected to deliver. Glencore increased its participation in Xstrata from 40% to 100%, so the takeover enabled Glencore to consolidate Xstrata's results for the first time. Consolidation delivers that benefit, but at the same time Glencore managed to transfer hundreds of millions of dollars in that increased profit participation to companies it controls in Singapore. As indicated earlier, Glencore's statement about synergies was that a large part of the synergy would be realised by existing marketing operations based on increased product flows from Xstrata. They were talking about a change in product flows delivering synergies not the ability to consolidate. In our opinion, the only apparent change in product flows have been on paper between related parties in Australia and Singapore resulting in profits formerly taxed in Australian being transferred to Singapore.

Prior to Glencore gaining control, Xstrata companies paid Glencore a small sales commission. In our opinion, the only purpose of making the change to related party sales, at a significant cost to the Australian companies, appears to be to transfer profit from Australian companies, taxed at 30%, to Singapore companies taxed at 17% or less. There is a concessional rate of 10% applied in Singapore to qualifying trading companies controlled by non-residents. In our opinion, Glencore's dominant purpose in directing its Australian and Singapore companies to enter into these revised marketing arrangements would appear to be profit shifting from Australia.

It is worth noting that a head entity and each member of a tax consolidation group must be an Australian resident for tax purposes. If AZSA were found to be domiciled in Switzerland it cannot be a member of a tax consolidation group. The current management governance structure may put the whole tax consolidation status at risk. Loss of residency status might also impact the effectiveness of cross guarantees.

In note 2 of the financial statements the directors of both companies state that they do not believe there to be any users who require general purpose financial statements. For 2013, AZSA has only provided special purpose financial statements covering its own operations. An explanation of the lack of consolidated accounts and their justification for concluding an absence of users would be helpful.

Contrary to the view expressed by directors the Synod is strongly of the view that both AZSA and GCIA have a number of users of audited general purpose financial statements of these companies. Such users include management, staff, creditors, joint venture partners, government agencies and members of the community interested in understanding whether or not these companies are meeting their appropriate obligations with respect to income tax and whether the directors are acting in the best interests of the company and not, given the

Glencore group's overriding global governance structure, the best interests of persons other than the company.

The centralised treasury needs to take country risk into account in lending to subsidiaries, but lending US dollars to an Australian subsidiary is likely to result in a lower sovereign risk than Glencore has in aggregate. There is little support for the transfer of high margin on the basis of sovereign risk and given operational risk is under the direct control of the parent board and its officers there is also little support for higher lending margins for Australian subsidiaries based on assumptions of higher market risk. There may be a case for higher margins on revolving credit arrangements, but the cost of debt is based on market rates margin for lenders risk associated with this type of facility.

It is our understanding that AZSA is paying 8.25% to 9% fixed rates on intra group debt when it could borrow from local banks at a much lower rate. AZSA has argued that these borrowing date back to 2007/8 when the RBA base rate was 6.75% (this rate quoted by Glencore is for Australian dollar denominated borrowings whereas AZSA is understood to have borrowed in US dollars given its accounts reflect gains and losses on foreign currency loans). The 8.25 to 9% rates were supposedly competitive at that time as the borrowing company had significant levels of debt, its risk or credit rating was not great, and the commodity industry was perceived to be risky. However, the parent company could have chosen to take action to reduce the debt levels of AZSA and to remedy the credit rating of AZSA.

AZSA appears to claim tax deductions on its interest payments, while lending a large proportion of its borrowings to related parties interest free.

A revolving credit facility would be far more efficient. In 2013 it appears only 75% of borrowings were used in the business, but in prior years the figure appears to have been as low as 33%. Interest is generally not deductible to the extent that it is on-lent at a lower rate or to the extent that the interest cost exceeds the return on re-investment of those funds, as AZSA has done by placing such large amounts on deposit.

The arrangements seem odd to us. We would have expected AZSA to borrow a balance of fixed and floating rate facilities with a mix of rollover dates linked to budget cash surplus expectations. This would have allowed the AZSA board to manage its legal entity's interest expense to its lowest practical cost for its targeted level of gearing.

Market and operational risks could have been higher in Australia at the time, but these operational risks were a function of the Parent's control and management of its Australian subsidiaries. Market risks were more likely evenly spread across Xstrata's global operations. In our view, there is no substantial evidence that there should be any difference in premium between the rates at which the Parent company borrowed at the time and the rate that was charged to AZSA. In our view, there is also no substantial evidence that the Parent could not recall those loans and replace them with more commercially appropriate and flexible facilities that reflect the Parent's current rate of borrowing.

GCIA incurred $374 million as interest expense on its related party debt in 2013. This was up by 44% compared to 2012 yet the related party debt on which it is based only increased by 5%.

At the end of 2013, GCIA was holding cash of $348 million. There would appear to be another potential synergy saving for the Group if debt was paid down and instead GCIA relied on revolving credit facilities to be accessed as and when needed.

Following Glencore's acquisition of Xstrata there has been a progressive restructuring of AZSA's Australian coal marketing arrangements. This has resulted in a significant reduction in AZSA sales to third parties and an increase in sales to related parties. At the same time the Glencore group has established a number of new coal marketing companies in Singapore. These companies appear to be paying concessional tax rates and have shown a significant increase in turnover. It is not possible to determine the extent to which AZSA may have been adversely affected by these new Group arrangements given there has been a concurrent downturn in coal market prices.

Prior to Glencore's takeover of Xstrata, its Australian coal subsidiaries disclosed sales commissions paid to Glencore. These disclosures stopped in 2012. From that point onwards GCIA's sales to related parties as a percentage of total sales increased from 16% to 27% in 2012 and then increased in 2013 to 46%.

Note 5 to the Group's Annual Financial Statements in relation to impairment describes the original allocation (in 2012) of Goodwill between Marketing Operations and Mining Operations. At the end of 2013 it conducted impairment testing on its Goodwill assets and found that Goodwill allocated to Mining Operations should be impaired. The full $7.5 billion allocation to mining was written down. Goodwill allocated to Marketing Operations was not impaired suggesting its margins were relatively unaffected by the change in demand for coal or the drop in price, possibly even a fixed margin per tonne that exceeds the commission rate previously paid be Xstrata under its ownership of the same business.

34.3.2 Luxembourg Leaks Cases

The leak of letters from PricewaterhouseCoopers to Luxembourg tax authorities for advance rulings[128] on tax arrangements for 343 corporate clients has been of significant concern to governments and tax authorities who may have been impacted by these arrangements. Australian companies and MNEs operating in Australia were amongst those who made use of PricewaterhouseCoopers services in setting up arrangements in Luxembourg.

It is alleged that hundreds of billions of dollars were channelled through Luxembourg by the advance rulings provided by the Luxembourg tax authority, resulting in the MNEs involved paying billions of dollars less in tax compared to if the arrangements were not in place.[129] Some MNEs enjoyed effective tax rates of less than 1% on the profits they shifted into Luxembourg.[130] It is further alleged that in many cases Luxembourg subsidiaries handling hundreds of millions of dollars in business maintain little presence and conduct little economic activity in Luxembourg.[131] One popular address – 5, rue Guillaume Kroll – is alleged to be home to more than 1,600 companies.[132]

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[128] UK Public Accounts Committee, 'Oral evidence: Tax avoidance: the role of large accountancy firms - follow-up, HC 860', 8 December 2014 , p. 7, http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/public-accounts-committee/tax-avoidance-the-role-of-large-accountancy-firms-followup/oral/16207.pdf

[129] Michael Hudson, Sasha Chavkin and Bart Mos, 'Big 4 Audit Firms Play Big Role in Offshore Murk', International Consortium of Investigative Journalists, icij.org, 5 November 2014, http://www.icij.org/project/luxembourg-leaks/big-4-audit-firms-play-big-role-offshore-murk

[130] Michael Hudson, Sasha Chavkin and Bart Mos, 'Big 4 Audit Firms Play Big Role in Offshore Murk', International Consortium of Investigative Journalists, icij.org, 5 November 2014, http://www.icij.org/project/luxembourg-leaks/big-4-audit-firms-play-big-role-offshore-murk

[131] Michael Hudson, Sasha Chavkin and Bart Mos, 'Big 4 Audit Firms Play Big Role in Offshore Murk', International Consortium of Investigative Journalists, icij.org, 5 November 2014, http://www.icij.org/project/luxembourg-leaks/big-4-audit-firms-play-big-role-offshore-murk

[132] Michael Hudson, Sasha Chavkin and Bart Mos, 'Big 4 Audit Firms Play Big Role in Offshore Murk', International Consortium of Investigative Journalists, icij.org, 5 November 2014, http://www.icij.org/project/luxembourg-leaks/big-4-audit-firms-play-big-role-offshore-murk

The alleged tax dodging activities by MNEs through Luxembourg have involved:[133]

- interest-free and micro-interest loans which avoid Luxembourg net wealth tax on capital;
- hybrid loans that are treated as debt but act like equity, which were used to realise profits as equity returns which avoid income and withholding taxes;
- total swap returns, in which a Cayman Islands company pays all the costs of a Luxembourg company. In return it is entitled to all Luxembourg profits;
- hidden contributions in which 90% of fees paid to Luxembourg companies are attributed to a Bermuda company that has assigned goodwill or a clientele to the Luxembourg company; and
- using a Luxembourg company to open a branch in Switzerland which operates under Swiss tax law with earnings not taxed in Luxembourg.

One of the primary advantages of doing business in Luxembourg is their tax system's treatment of income earned from intellectual property, which enjoys an 80% tax exemption.[134]

The extent of Luxembourg's role in facilitating tax dodging is shown by the US Bureau of Economic Analysis, which reported that US companies made profits totalling US$95 billion in Luxembourg in 2012.[135] They paid Luxembourg US$1.04 billion in tax: an effective tax rate of 1.1%.[136]

The process exposed by the Luxembourg leaks was that PricewaterhouseCoopers wrote to the Luxembourg tax authorities, Sociétés 6, seeking an advance ruling on tax arrangements for the MNE clients and these arrangements were then agreed to by the Luxembourg authorities.[137] Concern has in part been generated about how quickly Luxembourg would sign off on the proposed arrangements, with a Marius Kohl, then inspecteur principal of the Luxembourg tax authority, allegedly signing off on 39 tax agreements in a single day.[138] Further, it was reported in the press that Mr Kohl told the *Wall Street Journal* that he did not verify MNEs transfer-pricing models that he signed off on in the advance tax rulings.[139]

Marius Kohl was reported to be the sole arbiter on deals that channelled more than $140 billion a year of profits by foreign companies through Luxembourg.[140]

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[133] 'Lux leaks', *The Australian Financial Review,* 6 November 2014, p. 10.

[134] Jan Kleinnijenhuis, *5 Tips for Understanding the 'Lux Leaks' documents*, International Consortium of Investigative Journalists, available at: http://www.icij.org/project/luxembourg-leaks/your-head-spinning-5-tips-understand-lux-leaks-files

[135] Neil Chenoweth, 'From Luxembourg with love', *The Australian Financial Review,* 8-9 November 2014, p. 15.

[136] Neil Chenoweth, 'From Luxembourg with love', *The Australian Financial Review,* 8-9 November 2014, p. 15.

[137] UK Public Accounts Committee, 'Oral evidence: Tax avoidance: the role of large accountancy firms - follow-up, HC 860', 8 December 2014 , pp. 7-8, http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/public-accounts-committee/tax-avoidance-the-role-of-large-accountancy-firms-followup/oral/16207.pdf

[138] UK Public Accounts Committee, 'Oral evidence: Tax avoidance: the role of large accountancy firms - follow-up, HC 860', 8 December 2014 , p. 43, http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/public-accounts-committee/tax-avoidance-the-role-of-large-accountancy-firms-followup/oral/16207.pdf

[139] Tim Fernholz, 'Who minds the minders? The secrets of Luxembourg's multinational tax hustle, revealed', *Quartz*, 6 November 2014, http://qz.com/292407/the-secret-of-luxembourgs-multinational-tax-hustle-revealed/

[140] Neil Chenoweth, 'From Luxembourg with love', *The Australian Financial Review,* 8-9 November 2014, p. 14.

As Stephen Phillips, a member of the UK Public Accounts Committee, outlined many of the arrangements appear to have the characteristic of:[141]

> *The way it works is this: you will incorporate some companies in Luxembourg, and they will make loans to other companies in your group worldwide. Interest will be paid on those loans, and those interest payments will be deductable against your profits where you are actually operating, and you will have to pay much lower rates of taxation in Luxembourg, which PwC will be able to negotiate with the Luxembourg tax authorities in that jurisdiction.*

Many of the Luxembourg subsidiaries revealed in the leaked documents were treated as Luxembourg companies by Luxembourg authorities because they qualified for Luxembourg residence status on the basis of place of incorporation. Like Luxembourg, Australia's concept of residency also includes the place of incorporation. Australia's *Income Tax Assessment Act* (ITAA) further provides that a foreign company will also be a resident of Australia if it (a) carries on business in Australia and (b) has either its central management and control is in Australia or its voting power is controlled by residents of Australia.

Under today's multinational global corporate governance structures, the use of service companies (usually incorporated in low tax countries) in support of activities conducted in another country is common. Accounting functions are no different, so the existence of an accounting function in Luxembourg is likely to have little or nothing to do with a place where a company is carrying on a business.

Much emphasis was placed by PricewaterhouseCoopers Luxembourg on the location of physical board meetings for the purpose of residency. Such meetings were considered a relevant factor up to the 1980s when global communication was not so instant and when many multinational subsidiaries were still run as body corporates. Modern communication methods offer global management instant, safe and confidential communication procedures that are virtually face to face. Generally speaking, these methods have now replaced the need for formal board meetings in local and offshore multinational subsidiary companies. This is the now the global norm for administration of local operations under the "one global company" model used by most multinationals.

Despite elaborate concoctions of a physical presence in Luxembourg, the place of business and effective management of a secrecy jurisdiction subsidiary is not determined by a rubber stamping process operated by locally resident persons acting as nominated directors or locally employed staff acting under instruction from Australia to sign off on or process decisions already made by their global senior management located in Australia.

Multinational subsidiaries usually go to considerable length to avoid having to produce general purpose financial statements. One reason for this is that it avoids having to publish information about the number of meetings their nominated directors attended and/or the fact that very few board meetings were even held. It also avoids disclosing the possibility that their nominal Australian director(s) may not even have attended meetings involving key decisions on the company's operations or investments. E-mail evidence, or lack thereof, is often a more reliable indicator of where and how business decisions were actually made, but this is not publicly disclosed.

Non-disclosure avoids providing publicly available evidence that effective control and management is not with the board of the subsidiary company and/or that it is exercised by

[141] UK Public Accounts Committee, 'Oral evidence: Tax avoidance: the role of large accountancy firms - follow-up, HC 860', 8 December 2014 , p. 25, http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/public-accounts-committee/tax-avoidance-the-role-of-large-accountancy-firms-followup/oral/16207.pdf

persons residing outside the country of incorporation. Offshore effective control is the new norm for many multinational subsidiaries.

There is also the issue of these secrecy jurisdiction companies acting as undisclosed agents of the parent entity. The only economic benefit from many of these schemes is the avoidance of tax. The subsidiary companies and their directors (including shadow and de-facto directors) act as undisclosed agents of the Parent to achieve that benefit. The directors of Group subsidiaries paying fees to these secrecy jurisdiction companies are not acting in the best interest of their companies if their company's before tax result is adversely impacted, whether or not permitted by the company's constitution. Acting other than in the best interest of the company, but concurrently for the benefit of the group is evidence of an agency arrangement. When that arrangement has the dominant purpose and economic outcome of permitting the Parent to benefit from avoiding tax in Australia, the directors of the Australian company participating in the scheme have a dominant purpose of tax avoidance in Australia.

However, it is possible not all of these arrangements in Luxembourg may have been for tax purposes. Further, some may have been set up to avoid paying tax in jurisdictions other than Australia and may not have impacted on the tax liability and tax paid in Australia by a particular company.

When questioned by the UK Public Accounts Committee in December 2014, Kevin Nicholson, Head of Tax, PricewaterhouseCoopers LLP (UK), gave an example of a non-tax avoidance for operating through Luxembourg:[142]

> *If you take the private equity example, if you have a private equity house or a private equity structure, you can have hundreds of partners or investors from around the world; that has to be based somewhere. The reasons they would choose Luxembourg are, first, because they would get clarity from the ruling and, secondly, because they can effectively ensure there is no withholding tax coming out as the receipts come into the private equity house. Ultimately, that has absolutely no bearing on the taxation of either the partner or the thing they have invested in. The partners are still fully taxed if they are taxable—most of them aren't—and the company, if we say it is a UK company that they have invested in, is still taxed in the UK.*

On the tax avoidance side, Mr Nicholson explained that the Luxembourg authorities had created tax laws "to make it attractive for financing and the holding of investments."[143]

In a statement PricewaterhouseCoopers Luxembourg is reported to have stated the leaked material was dated and open to misinterpretation without a full set of documents or a complete understanding of the structures involved.[144] "We are prohibited from commenting on specific client matters but we reject any suggestion that there is anything improper about the firm's work", it said.[145]

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[142] UK Public Accounts Committee, 'Oral evidence: Tax avoidance: the role of large accountancy firms - follow-up, HC 860', 8 December 2014 , p. 9, http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/public-accounts-committee/tax-avoidance-the-role-of-large-accountancy-firms-followup/oral/16207.pdf

[143] UK Public Accounts Committee, 'Oral evidence: Tax avoidance: the role of large accountancy firms - follow-up, HC 860', 8 December 2014 , p. 9, http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/public-accounts-committee/tax-avoidance-the-role-of-large-accountancy-firms-followup/oral/16207.pdf

[144] Neil Chenoweth, 'Global PwC tax schemes exposed', *The Australian Financial Review,* 6 November 2014, p. 10.

[145] Neil Chenoweth, 'Global PwC tax schemes exposed', *The Australian Financial Review,* 6 November 2014, p. 10.

It is of deep concern the secretive nature of the arrangements that the Luxembourg authorities allowed to be put in place. While the rest of the European Union agreed in the late 1980s to share details of any advance tax agreements they negotiate, Luxembourg and Ireland have declined to share information.[146] Luxembourg even has laws to protect that secrecy, so that when the International Consortium of Investigative Journalists was about to disclose the Luxembourg leaks an American lawyer for PricewaterhouseCoopers wrote to them warning that further dissemination of the information would violate "concealment laws in Luxembourg."[147]

There have been many unfortunate assertions in the media that all the advance tax agreements signed off by Mr Kohl were legal. While they may have been legal under Luxembourg law, the Tax Justice Network has rightly pointed out that where a scheme has not been legally challenged in the countries potentially cheated of tax revenue, the best that can be said about the legality of the scheme is that it is indeterminate.[148] Their legality can't be determined until they've been put to the test.

The Commissioner of Taxation, Chris Jordan, was quoted in the media as stating that he had written to each country in the OECD's 38-member Forum on Tax Administration about the Luxembourg leak documents: "I have written to our tax treaty partners, inviting their collaboration in joint investigation of this data to understand any tax risks and to explore opportunities for joint compliance approaches."[149]

Walt Disney Co

In December 2014, *The Australian Financial Review* reported that Walt Disney Co began a restructure of its Australian operations with a $1 share trade and ended 25 days later with tax-free profits of $1.3 billion.[150] The article alleged that in 2008, income tax accounted for 18% of Disney's combined earnings of royalties and profits in Australia. In 2013 it was 5%.[151]

It was alleged dozens of Disney operating companies were moved from a US parent to a new holding structure in the UK. Disney's cash-rich operating companies were briefly owned by Luxembourg entities that stripped out their profits and then loaded them up with debt.[152]

One example given by *The Australian Financial Review* was Buena Vista (Australia), which was bought by Wedco Two (Luxembourg) S.a r.l for $582,000 in August 2009. It was then allegedly stripped of $89 million in dividends payments and onsold six days later for $1.22 billion in shares to The Walt Disney Company Limited in the UK.[153]

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[146] Neil Chenoweth, 'From Luxembourg with love', *The Australian Financial Review,* 8-9 November 2014, p. 14.

[147] Neil Chenoweth, 'Global PwC tax schemes exposed', *The Australian Financial Review,* 6 November 2014, p. 10.

[148] Tax Justice Network, 'PWC and Luxembourg: no, this wasn't 'legal' behaviour', http://www.taxjustice.net, 6 November 2014.

[149] Chenoweth, N., 'PwC Lux deals, ATO advice', The Australian Financial Review, 13 November 2014, p. 5.

[150] Neil Chenoweth, 'How Disney's tax bill was McDucked', *The Australian Financial Review,* 10 December 2014, p. 1.

[151] Chenoweth, N., 'How Disney's tax bill was McDucked', *The Australian Financial Review*, 10 December 2014, p. 1.

[152] Chenoweth, N., 'How Disney's tax bill was McDucked', *The Australian Financial Review*, 10 December 2014, p. 1.

[153] Chenoweth, N., 'How Disney's tax bill was McDucked', *The Australian Financial Review*, 10 December 2014, pp. 1, 10.

Disney's US$4 billion ($4.85 billion) restructure is detailed in correspondence from accounting firm Ernst and Young to then Luxembourg tax official Marius Kohl in October 2009.[154]

The Australian Financial Review stated that much of Disney's revenue is paid out as royalties, escaping local taxes.[155] On 3 March 2009, Disney set up a new organisation, The Walt Disney Company Europe, Middle East and Africa, which included responsibility for Australia.[156] The public announcement made no reference to the three Luxembourg companies Disney set up on the same day: Wedco One (Luxembourg) S.a r.l., Wedco Two (Luxembourg) S.a r.l. and Wedco Participations (Luxembourg) SCA.[157]

Subsidiary after subsidiary then allegedly had its ownership transferred to one of the three Luxembourg companies. Most were onsold to The Walt Disney Company Ltd in the UK, which ultimately was owned by Hammersmith Enterprises Ltd of the Caymans, which was itself owned by the Luxembourg companies.[158]

It was reported that in 2008, Buena Vista (Australia), Walt Disney Television Australia/New Zealand and The Walt Disney Company (Australia) earned $56 million before tax and paid Disney $35 million in royalties.[159]

On 17 July 2009 it was reported that Buena Vista Entertainment in the US transferred its one share in Buena Vista (Australia) to Disney Enterprises Inc, which now owned all the shares in each of the three Australian companies.[160]

The Australian Financial Review stated that a key issue was the difference between the book value of the Australian companies, which was quite low, and their market value, which was much higher.[161]

It was reported that on 28 July 2009, Disney Enterprises Inc in the US sold the three Australian companies to Wedco Two (Luxembourg) for their book value, which was just over $582,600.[162] *The Australian Financial Review* reported that in March 2009, the three Australian companies (Buena Vista (Australia), The Walt Disney Company (Australia) and Walt Disney Television (Australia/New Zealand) held $150 million in cash, despite their book value of only $584,000.[163]

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[154] Chenoweth, N., 'How Disney's tax bill was McDucked', *The Australian Financial Review*, 10 December 2014, p. 10.
[155] Chenoweth, N., 'How Disney's tax bill was McDucked', *The Australian Financial Review*, 10 December 2014, p. 10.
[156] Chenoweth, N., 'How Disney's tax bill was McDucked', *The Australian Financial Review*, 10 December 2014, p. 10.
[157] Chenoweth, N., 'How Disney's tax bill was McDucked', *The Australian Financial Review*, 10 December 2014, p. 10.
[158] Chenoweth, N., 'How Disney's tax bill was McDucked', *The Australian Financial Review*, 10 December 2014, p. 10.
[159] Chenoweth, N., 'How Disney's tax bill was McDucked', *The Australian Financial Review*, 10 December 2014, p. 10.
[160] Chenoweth, N., 'How Disney's tax bill was McDucked', *The Australian Financial Review*, 10 December 2014, p. 10.
[161] Chenoweth, N., 'How Disney's tax bill was McDucked', *The Australian Financial Review*, 10 December 2014, p. 10.
[162] Chenoweth, N., 'How Disney's tax bill was McDucked', *The Australian Financial Review*, 10 December 2014, p. 10.
[163] Chenoweth, N., 'How Disney's tax bill was McDucked', *The Australian Financial Review*, 10 December 2014, p. 10.

In the next two days, Buena Vista (Australia) paid its new Luxembourg parent a $45 million dividend, and then paid it another $44 million to buy the other two Australian companies from it.[164]

The Australian Financial Review stated that, after a series of shuffles, Buena Vista (Australia) was sold to The Walt Disney Company Ltd in the UK, for shares, by 13 August. The sale was at market value.[165]

It was reported that Buena Vista (Australia)'s price in the sale had jumped from $582,600 book value the Luxembourg companies paid for it, to the market value that the British company paid for it, which was £618.55 million (at the time equal to $1.217 billion).[166]

Ernst and Young noted that no Luxembourg tax would be payable on the Buena Vista (Australia) dividend, nor on the capital gains, which would count as "hidden capital" of the Luxembourg.[167]

It was stated by *The Australian Financial Review* that the revaluation had the effect of increasing the equity base of the British Disney companies, helping them to meet thin capitalisation rules as Disney loaded them up with debt.[168]

The Australian Financial Review stated that today Disney's Australian companies, now merged into what is called The Walt Disney Company (Australia) Pty Ltd, earn Disney $160 million in royalties and profits. About half of all revenue from Australia is paid in royalties directly to Disney overseas.[169] That structure means that Australian tax payments have halved since 2009.[170] *The Australian Financial Review* stated that the tax paid as a proportion of Disney's royalties and profits in Australia has decreased from 19.4% in 2008 to 5% in 2013.[171]

Disney's response to the analysis provided by *The Australian Financial Review* was to state:[172]

> *Our global effective tax rate has averaged 34 per cent for the past five years and 35 per cent in the most recent years. We manage our tax affairs responsibly and aim to fully comply with all applicable tax rules. Your assertions are not based on an accurate understanding of our global tax position.*

The US based Citizens for Tax Justice report Disney paying an average tax rate of 27% on US earnings in the period 2008 to 2012.[173] However, it needs to be remembered that

[164] Chenoweth, N., 'How Disney's tax bill was McDucked', *The Australian Financial Review*, 10 December 2014, p. 10.
[165] Chenoweth, N., 'How Disney's tax bill was McDucked', *The Australian Financial Review*, 10 December 2014, p. 10.
[166] Chenoweth, N., 'How Disney's tax bill was McDucked', *The Australian Financial Review*, 10 December 2014, p. 10.
[167] Chenoweth, N., 'How Disney's tax bill was McDucked', *The Australian Financial Review*, 10 December 2014, p. 10.
[168] Chenoweth, N., 'How Disney's tax bill was McDucked', *The Australian Financial Review*, 10 December 2014, p. 10.
[169] Chenoweth, N., 'How Disney's tax bill was McDucked', *The Australian Financial Review*, 10 December 2014, p. 10.
[170] Chenoweth, N., 'How Disney's tax bill was McDucked', *The Australian Financial Review*, 10 December 2014, p. 10.
[171] Chenoweth, N., 'How Disney's tax bill was McDucked', *The Australian Financial Review*, 10 December 2014, p. 10.
[172] Chenoweth, N., 'How Disney's tax bill was McDucked', *The Australian Financial Review*, 10 December 2014, p. 10.

effective tax rate calculations have serious limitations and that a company able to shift and hide profit as an expense will have removed that profit completely from the effective tax rate calculation. So a company engaged in large scale profit shifting can still appear to have a high effective tax rate. The Synod is not implying that this is the case with Walt Disney Co, we are merely pointing out the limitations of relying on effective tax rate calculations.

Citizens for Tax Justice report that the Walt Disney Company had US$1.5 billion as unrepatriated foreign income in 2013.[174] One of the large incentives for US based companies to tax dodge is the failure of US law to require all foreign income to have to be repatriated and taxed in the US, allowing many US based MNEs to park foreign income in secrecy jurisdictions untaxed or very lightly taxed.

IKEA

The Australian Financial Review reported that IKEA's Australian arm has earned an estimated $1 billion in profits since 2003, and almost all of it has been exported tax-free to Luxembourg and the Netherlands.[175]

The documents from PricewaterhouseCoopers to Luxembourg authorities detail secret advance tax agreements in 2009, and identify IKEA entities that have received hundreds of millions of dollars from the Australian operations – including franchise fees, interest payments and fees for a "risk agreement" that to date has cost $260 million.[176]

The Australian Financial Review reported that in contrast to the offshore profits, IKEA reported losing money here every year from the mid-1980s until 2002, when the accumulated losses stood at $67 million.[177] They reported that it was not until 2013, after a decade of small profits, that IKEA finally wiped out the accumulated losses to put its Australian arm in the black after 30 years.[178]

The newspaper reported that in its 2009 correspondence with the Luxembourg tax authorities, PricewaterhouseCoopers described how the IKEA Group owns and operates 264 IKEA stores in 24 countries including Australia, and owns the exclusive rights to develop the IKEA product range. As designer of the products it holds the intellectual property and thus can charge a mark-up when it sells the products to stores via IKEA Supply AG.[179]

The newspaper went on to report that from 2002 to 2013, IKEA Supply AG charged the Australian arm $2.67 billion as the cost of products. These were sold in the Australian stores for $4.76 billion. After other costs, IKEA ended up with total pre-tax profits of $103 million for the period, on which it paid $31 million in tax.[180] However, *The Australian Financial Review* reported, together with the pre-tax profits here, the Australian earnings for IKEA have been

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[173] Citizens for Tax Justice, http://ctj.org/corporatetaxdodgers/tax-dodgers.php?id=281

[174] Citizens for Tax Justice, http://ctj.org/corporatetaxdodgers/tax-dodgers.php?id=281

[175] Neil Chenoweth, 'IKEA's profit mostly tax-free', *The Australian Financial Review,* 6 November 2014, p. 11.

[176] Neil Chenoweth, 'IKEA's profit mostly tax-free', *The Australian Financial Review,* 6 November 2014, p. 11.

[177] Neil Chenoweth, 'IKEA's profit mostly tax-free', *The Australian Financial Review,* 6 November 2014, p. 11.

[178] Neil Chenoweth, 'IKEA's profit mostly tax-free', *The Australian Financial Review,* 6 November 2014, p. 11.

[179] Neil Chenoweth, 'IKEA's profit mostly tax-free', *The Australian Financial Review,* 6 November 2014, p. 11.

[180] Neil Chenoweth, 'IKEA's profit mostly tax-free', *The Australian Financial Review,* 6 November 2014, p. 11.

close to $1 billion.[181] Further, they reported that with negligible tax paid offshore the $30.7 million of Australian tax paid represents a tax rate of 3%.[182]

The Australian Financial Review stated that the worldwide IKEA Group prides itself on maintaining a minimum 10% profit margin on sales each year. By that calculation, the newspaper concluded that, in Australia, that would mean it must have earned $460 million in profit from 2003 to 2013.[183] The newspaper stated that for IKEA to maintain its 10% margin on sales, it must have factored in a profit margin of at least $360 million into the cost it charges the Australian stores for its products.[184] It was reported in the period 2002 to 2013 $532 million was paid offshore.[185] Almost all these payments appear to end up with Inter IKEA Holding SA in Luxembourg.[186]

The newspaper reported that while the IKEA Group holds the intellectual property for IKEA products, Inter IKEA Systems BV holds the intellectual property on the stores.[187] It was reported that Inter IKEA Systems BV charges 3% of the retail price on every IKEA product to control, safeguard and develop the IKEA concept.[188] *The Australian Financial Review* reported that in 2008, when IKEA global sales totalled €22.49 billion, €747 million flowed in franchise fees to Inter IKEA Systems BV, virtually all of it tax-free.[189] The newspaper reported that from 2002 to 2013, franchise fees in Australia totalled $159 million.[190]

The Australian Financial Review reported that from 2006 IKEA began including under “financial expenses” a figure for “Payment under Risk Agreement”. That amount was $312,000 in 2006, but by 2008 had grown to $54 million.[191] This was reported to have coincided with rises in inter-company loans that replaced bank funding.[192] The newspaper stated that the IKEA Group has huge cash reserves, but from 2002 to 2013 it paid $114 million in interest and $260 million for the Risk Assessment.[193] The Synod acknowledges that IKEA may have currency exposure risks between what it sells its products for in Australia in Australian dollars and that it may purchase from some suppliers in other currencies, opening up risk of increased supply costs against fixed sales prices. Such risk may be dealt with by risk hedging contracts.

[181] Neil Chenoweth, ‘IKEA’s profit mostly tax-free’, *The Australian Financial Review,* 6 November 2014, p. 11.
[182] Neil Chenoweth, ‘IKEA’s profit mostly tax-free’, *The Australian Financial Review,* 6 November 2014, p. 11.
[183] Neil Chenoweth, ‘IKEA’s profit mostly tax-free’, *The Australian Financial Review,* 6 November 2014, p. 11.
[184] Neil Chenoweth, ‘IKEA’s profit mostly tax-free’, *The Australian Financial Review,* 6 November 2014, p. 11.
[185] Neil Chenoweth, ‘IKEA’s profit mostly tax-free’, *The Australian Financial Review,* 6 November 2014, p. 11.
[186] Neil Chenoweth, ‘IKEA’s profit mostly tax-free’, *The Australian Financial Review,* 6 November 2014, p. 11.
[187] Neil Chenoweth, ‘IKEA’s profit mostly tax-free’, *The Australian Financial Review,* 6 November 2014, p. 11.
[188] Neil Chenoweth, ‘IKEA’s profit mostly tax-free’, *The Australian Financial Review,* 6 November 2014, p. 11.
[189] Neil Chenoweth, ‘IKEA’s profit mostly tax-free’, *The Australian Financial Review,* 6 November 2014, p. 11.
[190] Neil Chenoweth, ‘IKEA’s profit mostly tax-free’, *The Australian Financial Review,* 6 November 2014, p. 11.
[191] Neil Chenoweth, ‘IKEA’s profit mostly tax-free’, *The Australian Financial Review,* 6 November 2014, p. 11.
[192] Neil Chenoweth, ‘IKEA’s profit mostly tax-free’, *The Australian Financial Review,* 6 November 2014, p. 11.
[193] Neil Chenoweth, ‘IKEA’s profit mostly tax-free’, *The Australian Financial Review,* 6 November 2014, p. 11.

The newspaper reported that in addition to charging franchise fees the Inter IKEA Group provides finance for the IKEA Group.[194] The company at the heart of IKEA's finance operation was a Netherland Antilles company, Inter IKEA Holding NV, which in turn loaned money to a Belgium company, Inter IKEA Treasury SA, and to Inter IKEA Finance in Luxembourg.[195] According to *The Australian Financial Review,* the Australian intra-company interest payments would eventually find their way into this structure, as virtually tax-free income.[196]

The newspaper reported that under pressure from the European Union, both Belgium and Luxembourg were being forced to make changes to their tax laws which would close the loopholes for finance companies that IKEA had exploited, which were to take effect from 1 January 2010.[197] To overcome the problem that would create for IKEA, it is reported that PricewaterhouseCoopers put forward a subtle transformation in which Inter IKEA Finance Holdings SA would be turned into a "Société de Participations Financières" as the new centre of financial activities with tax advantages, after opening a branch of Inter IKEA Finance in Switzerland.[198]

The Australian Financial Review reported that PricewaterhouseCoopers stressed that under Luxembourg law no interest expense paid in Switzerland would be claimed against Inter IKEA Finance's Luxembourg income. Profits in Switzerland could not be taxed in Luxembourg either.[199] It was reported that over time the Belgium company would forward up to €6 billion to Inter IKEA Finance Holdings SA, through to the Swiss branch, with only €6 million remaining in Luxembourg.[200] The newspaper stated that while it appeared from the outside that Inter IKEA Finance was a Luxembourg company enjoying all the benefits of an EU-member country, in effect it was now Swiss.[201]

The Australian Financial Review reported that Inter IKEA's Finance's balance sheet showed assets of €229 million. It is reported that the company decided to revalue them by €5 billion.[202] It then proposed to pay out the €5 billion to its unnamed shareholders as a "repayment of fiscal capital", which was tax free and did not attract a withholding tax.[203] The newspaper stated that the Luxembourg documents show Inter IKEA Finance's 2011 tax return showed it only paid a "wealth tax" of €199,170 and income tax of only €1,575.[204]

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[194] Neil Chenoweth, 'IKEA's profit mostly tax-free', *The Australian Financial Review,* 6 November 2014, p. 11.
[195] Neil Chenoweth, 'IKEA's profit mostly tax-free', *The Australian Financial Review,* 6 November 2014, p. 11.
[196] Neil Chenoweth, 'IKEA's profit mostly tax-free', *The Australian Financial Review,* 6 November 2014, p. 11.
[197] Neil Chenoweth, 'IKEA's profit mostly tax-free', *The Australian Financial Review,* 6 November 2014, p. 11.
[198] Neil Chenoweth, 'IKEA's profit mostly tax-free', *The Australian Financial Review,* 6 November 2014, p. 11.
[199] Neil Chenoweth, 'IKEA's profit mostly tax-free', *The Australian Financial Review,* 6 November 2014, p. 11.
[200] Neil Chenoweth, 'IKEA's profit mostly tax-free', *The Australian Financial Review,* 6 November 2014, p. 11.
[201] Neil Chenoweth, 'IKEA's profit mostly tax-free', *The Australian Financial Review,* 6 November 2014, p. 11.
[202] Neil Chenoweth, 'IKEA's profit mostly tax-free', *The Australian Financial Review,* 6 November 2014, p. 11.
[203] Neil Chenoweth, 'IKEA's profit mostly tax-free', *The Australian Financial Review,* 6 November 2014, p. 11.
[204] Neil Chenoweth, 'IKEA's profit mostly tax-free', *The Australian Financial Review,* 6 November 2014, p. 11.

A spokeswomen for IKEA Australia told *The Australian Financial Review* it was not the company's policy to comment on transactions and payments.[205]

Amazon

The Australian Financial Review reported the Luxembourg leaks documents showed how Amazon pays virtually no tax for its non-US earnings, including in Australia.[206] It was reported that Amazon Australia reported that from 4 June 2013 to 31 December 2013 its net sales were only $1.5 million.[207] After operating expenses of $1.2 million for technology, content and "fulfilment", Amazon Australian Services paid a tax rate in the US of 36%, or $96,000.[208] The net profit was $170,000.[209]

The newspaper reported that almost half of Amazon's income outside of the US ends up in a Luxembourg company, Amazon EU S.à r.l, which was the beneficiary in 2013 when Amazon made £4.3 billion ($7.9 billion) on sales in the UK and paid only £4.2 million in income tax.[210]

Amazon EU's 2009 accounts were reported to show €5.5 billion ($8 billion) of income.[211] The cost of Amazon's products accounted for 75% of net turnover. After accounting for Amazon's shipping, marketing and other costs that left €913 million of profits.[212] Yet, Amazon EU only reported profit of €15 million and it paid €4 million in tax.[213]

The Australian Financial Review reported a secret appendix to the annual report filed with the Luxembourg government shows the difference between the €913 million of profits and the reported profit of €15 million was channelled into two related-party deals.[214] Amazon EU was reported to have paid €379 million in "service fee expense" and royalties to Amazon Europe Holdings Technologies.[215] Amazon Europe paid €105 million to Amazon Technologies Inc in Nevada to licence the rights to Amazon's intellectual property - the patents and software for the websites.[216] Amazon Europe then onsold the rights to use this intellectual property to Amazon EU for €519 million, five times that it had paid the US company.[217] It was reported that Amazon Europe made an instant profit of €414 million,

[205] Neil Chenoweth, 'IKEA's profit mostly tax-free', *The Australian Financial Review,* 6 November 2014, p. 11.
[206] Neil Chenoweth, 'Amazon and the case of the missing $1.7b', *The Australian Financial Review*, 7 November 2014, p.1.
[207] Neil Chenoweth, 'Amazon and the case of the missing $1.7b', *The Australian Financial Review*, 7 November 2014, p.10.
[208] Neil Chenoweth, 'Amazon and the case of the missing $1.7b', *The Australian Financial Review*, 7 November 2014, p.10.
[209] Neil Chenoweth, 'Amazon and the case of the missing $1.7b', *The Australian Financial Review*, 7 November 2014, p.10.
[210] Neil Chenoweth, 'Amazon and the case of the missing $1.7b', *The Australian Financial Review*, 7 November 2014, p.10.
[211] Neil Chenoweth, 'Amazon and the case of the missing $1.7b', *The Australian Financial Review*, 7 November 2014, p.10.
[212] Neil Chenoweth, 'Amazon and the case of the missing $1.7b', *The Australian Financial Review*, 7 November 2014, p.10.
[213] Neil Chenoweth, 'Amazon and the case of the missing $1.7b', *The Australian Financial Review*, 7 November 2014, p.10.
[214] Neil Chenoweth, 'Amazon and the case of the missing $1.7b', *The Australian Financial Review*, 7 November 2014, p.10.
[215] Neil Chenoweth, 'Amazon and the case of the missing $1.7b', *The Australian Financial Review*, 7 November 2014, p.10.
[216] Neil Chenoweth, 'Amazon and the case of the missing $1.7b', *The Australian Financial Review*, 7 November 2014, p.10.
[217] Neil Chenoweth, 'Amazon and the case of the missing $1.7b', *The Australian Financial Review*, 7 November 2014, p.10.

which would have been taxable, except that Amazon Europe is a limited partnership and therefore doesn't pay tax in Luxembourg.[218]

The newspaper reported that Amazon EU ended up paying 0.5% tax and Amazon Europe's money ended up tax-free in Gibraltar.[219]

Based on the 2009 accounts, *The Australian Financial Review* reported that for every $100 that was earned from sales by Amazon, $26 went in shipping fees and $8.30 on marketing and commissions. There are other costs – bank and credit card fees, office costs and such-like, that come to $4.40. Staff salaries were stated to make up 80 cents in the $100.[220] That left $35, which the newspaper stated would have been profit, except that Amazon paid $7 to other Amazon companies as "service fee expense" and that appears to end up in a tax haven.[221] Another $28 goes to a Luxembourg limited partnership, Amazon Europe Holding Technology, as a payment for intellectual property.[222] Amazon Europe has already bought the rights to use the IP from another Amazon company, in Nevada but it only paid $5.60 for it.[223] So Amazon Europe has a $22.40 profit, which it sends tax-free to Gibraltar.[224] So, *The Australian Financial Review,* stated that with the inter-company fees that's $29.40 tax free.[225]

The Australian Financial Review stated things had changed since 2009, with US media outlets reporting Amazon Europe HT's profits had halved by 2012.[226] The newspaper stated the general conclusion was that Amazon had toned down its aggressive transfer pricing strategy, following demands for allegedly unpaid taxes by the US and French Governments.[227] It was reported that Amazon Europe HT received less royalties from Amazon EU, while at the same time Amazon Europe HT began paying more to Amazon Technologies in Arizona.[228] Amazon Europe HT's profit was reported to have plunged from €417 million in 2010 to only €85 million.[229]

The Australian Financial Review reported that Amazon companies didn't stop paying royalties, they just didn't pay them to Amazon Europe HT.[230] It was reported the accounts

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[218] Neil Chenoweth, 'Amazon and the case of the missing $1.7b', *The Australian Financial Review*, 7 November 2014, p.10.
[219] Neil Chenoweth, 'Amazon and the case of the missing $1.7b', *The Australian Financial Review*, 7 November 2014, p.10.
[220] Neil Chenoweth, 'From Luxembourg with love', *The Australian Financial Review,* 8-9 November 2014, p. 15.
[221] Neil Chenoweth, 'From Luxembourg with love', *The Australian Financial Review,* 8-9 November 2014, p. 15.
[222] Neil Chenoweth, 'From Luxembourg with love', *The Australian Financial Review,* 8-9 November 2014, p. 15.
[223] Neil Chenoweth, 'From Luxembourg with love', *The Australian Financial Review,* 8-9 November 2014, p. 15.
[224] Neil Chenoweth, 'From Luxembourg with love', *The Australian Financial Review,* 8-9 November 2014, p. 15.
[225] Neil Chenoweth, 'From Luxembourg with love', *The Australian Financial Review,* 8-9 November 2014, p. 15.
[226] Neil Chenoweth, 'Amazon and the case of the missing $1.7b', *The Australian Financial Review*, 7 November 2014, p.10.
[227] Neil Chenoweth, 'Amazon and the case of the missing $1.7b', *The Australian Financial Review*, 7 November 2014, p.10.
[228] Neil Chenoweth, 'Amazon and the case of the missing $1.7b', *The Australian Financial Review*, 7 November 2014, p.10.
[229] Neil Chenoweth, 'Amazon and the case of the missing $1.7b', *The Australian Financial Review*, 7 November 2014, p.10.
[230] Neil Chenoweth, 'Amazon and the case of the missing $1.7b', *The Australian Financial Review*, 7 November 2014, p.10.

showed a huge rise in royalty payments from other Amazon subsidiaries to Amazon EU.[231] In 2013 alone, Amazon EU was reported to have banked €1.8 billion in royalties from other Amazon companies around the world.[232] It was reported that less than a third of this amount was paid on to Amazon Europe HT, with €1.28 billion of royalties staying with Amazon EU.[233]

The newspaper reported that Amazon EU ended up paying even less tax, reporting a €68 million loss in 2012.[234] It was further reported that in 2013, instead of paying tax, it got a €5.5 million tax benefit.[235] *The Australian Financial Review* suggested the leaked documents from Luxembourg may provide a pointer to where all the money had gone: accounts for subsidiaries like Amazon Media EU S.à r.l showed growing payments as intercompany fees and costs.[236]

The newspaper suggested, in effect, Amazon had pushed the royalties loop further down the chain, to Amazon EU and below, making it harder for the US and Europe to chase it.[237]

Amazon was reported to have issued a statement saying it had not received any special tax treatment from Luxembourg.[238] "We are subject to the same tax laws as other companies operating here", it said.[239]

A European Commission (EC) draft report, dated 7 October 2014 was released in January 2015, presented its preliminary ruling on the secret tax deal between Luxembourg authorities and Amazon. The report accused the electronic retailer of writing an agreement with Luxembourg tax authorities in 2003 in order to underpay taxes on its non-US earnings, constituting illegal state aid by the European duchy. The EC opened an in-depth investigation in order to examine whether the decision by Luxembourg tax authorities regarding the corporate tax paid by Amazon in Luxembourg complies with the European Union (EU) rules on state aid. The draft report revealed that the agreement "allowed the online bookseller to make more than 99 per cent of its non-US earnings tax free in an entity that has no tax residence".[240]

The investigation concerned a tax ruling concluded on 6 November 2003 between Luxembourg tax authorities and the Amazon group.[241] In response to the EC's request for information in June 2014, Luxembourg authorities submitted documents including:

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[231] Neil Chenoweth, 'Amazon and the case of the missing $1.7b', *The Australian Financial Review*, 7 November 2014, p.10.
[232] Neil Chenoweth, 'Amazon and the case of the missing $1.7b', *The Australian Financial Review*, 7 November 2014, p.10.
[233] Neil Chenoweth, 'Amazon and the case of the missing $1.7b', *The Australian Financial Review*, 7 November 2014, p.10.
[234] Neil Chenoweth, 'Amazon and the case of the missing $1.7b', *The Australian Financial Review*, 7 November 2014, p.10.
[235] Neil Chenoweth, 'Amazon and the case of the missing $1.7b', *The Australian Financial Review*, 7 November 2014, p.10.
[236] Neil Chenoweth, 'Amazon and the case of the missing $1.7b', *The Australian Financial Review*, 7 November 2014, p.10.
[237] Neil Chenoweth, 'Amazon and the case of the missing $1.7b', *The Australian Financial Review*, 7 November 2014, p.10.
[238] Neil Chenoweth, 'Amazon and the case of the missing $1.7b', *The Australian Financial Review*, 7 November 2014, p.10.
[239] Neil Chenoweth, 'Amazon and the case of the missing $1.7b', *The Australian Financial Review*, 7 November 2014, p.10.
[240] Neil Chenoweth, 'EC explains how Amazon made $4.5 billion in 'stateless' profits', *Australian Financial Review,* 21 January 2015, http://www.afr.com/p/national/ec_explains_how_amazon_made_billion_tnY3a4LoeebeM6yqjip3SJ
[241] European Commission, 'Alleged aid to Amazon – Luxembourg', 7 October 2014, Brussels, SA.38944, p. 5.

- “A letter by Amazon dated 23 October 2003 requesting the acceptance of the Luxembourgish tax authorities of the pricing arrangement between Lux SCS and Amazon EU Sarl for Luxembourg corporate income tax purposes”;[242]
- “A letter by the tax advisor of Amazon on behalf of Amazon dated 31 October 2003, requesting the approval of the Luxembourgish tax authorities of the legal structure of Amazon for Luxembourg corporate income tax purposes”;[243] and
- A letter dated 6 November 2003 from Luxembourg authorities to Amazon, stating that those authorities “approve of the content of the letters of 23 October 2003 and 31 October 2003 regarding the proposed tax treatment by the Luxembourgish tax authorities of Amazon’s future activities”[244]

The document that was assessed was the letter dated 6 November 2003 (the contested tax ruling), which approved the transfer pricing arrangement and legal structure of the company described in the previous letters.[245] The EC investigation is primarily examining the transfer pricing agreement approved in the tax ruling. According to the letters of 23 October 2003 and 31 October 2003, Amazon intended to restructure its European business operations by establishing its European headquarters in Luxembourg, which was effectively put in place and did not change until the end of 2013.[246] At a hearing of the UK House of Commons Committee of Public Accounts in 2012 Amazon indicated that “all strategic functions for Amazon’s business in Europe are located in Luxembourg”.[247] In examining the transfer pricing arrangement between Amazon and Luxembourg, the EC concluded that:

- Lux SCS (Amazon transparent entity for tax purposes), would “obtain the right […] to exploit intangibles owned and developed in the US in exchange for a buy-in licence and a cost-sharing agreement […] the terms and conditions of those agreements would be, according to Amazon’s tax advisor, at arm’s length”;[248]
- The letter of 23 October 2003 indicated that “Amazon developed a specific transfer pricing arrangement, under which the licence fee that LuxOpCo will be required to pay to Lux SCS for the use of Amazon group’s IP (the Licence Fee) would be established. The Licence Fee was approved by the contested tax ruling”.[249]

Despite the fact that Lux SCS is considered transparent for tax purposes, the non-resident partners of the SCS or the SCS itself could still be taxed in Luxembourg if they had a permanent establishment in the country.[250] For this reason Amazon also requested confirmation from Luxembourg authorities that “neither the partners of Lux SCS for Lux SCS itself will have any tangible presence in Luxembourg”.[251] This means that Lux SCS was not

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[242] European Commission, ‘Alleged aid to Amazon – Luxembourg’, 7 October 2014, Brussels, SA.38944, p. 7.
[243] European Commission, ‘Alleged aid to Amazon – Luxembourg’, 7 October 2014, Brussels, SA.38944, p. 7.
[244] European Commission, ‘Alleged aid to Amazon – Luxembourg’, 7 October 2014, Brussels, SA.38944, p. 7.
[245] European Commission, ‘Alleged aid to Amazon – Luxembourg’, 7 October 2014, Brussels, SA.38944, p. 7.
[246] European Commission, ‘Alleged aid to Amazon – Luxembourg’, 7 October 2014, Brussels, SA.38944, p. 7.
[247] European Commission, ‘Alleged aid to Amazon – Luxembourg’, 7 October 2014, Brussels, SA.38944, p. 9.
[248] European Commission, ‘Alleged aid to Amazon – Luxembourg’, 7 October 2014, Brussels, SA.38944, p. 10.
[249] European Commission, ‘Alleged aid to Amazon – Luxembourg’, 7 October 2014, Brussels, SA.38944, p. 11.
[250] European Commission, ‘Alleged aid to Amazon – Luxembourg’, 7 October 2014, Brussels, SA.38944, p. 12.
[251] European Commission, ‘Alleged aid to Amazon – Luxembourg’, 7 October 2014, Brussels, SA.38944, p. 12.

subjected to municipal business tax, and the partners (as tax non-residents in Luxembourg), were not subjected to corporate income tax in Luxembourg on their partnership interest in the company.[252] Furthermore, all the royalties received from the licensing agreement and interest received from intra-group loans by Lux SCS were not taxed in Luxembourg, but in the country of residence of the partners in Lux SCS to whom the profits of Lux SCS were allocated on a yearly basis.[253] In response to the investigation, Luxembourg authorities submitted that the Amazon tax ruling was in line with the general tax ruling practice of MNEs in Luxembourg, and with the OECD principles.[254] The EC identified that the main question in the case was "whether the contested tax ruling confers a selective advantage upon Amazon in so far as it results in a lowering of its tax liability in Luxembourg".[255] In regards to this, the EC concluded that:

- "The ruling gives rise to a loss of State resources. That is because any reduction of tax for Amazon results in a loss of tax revenue that otherwise would have been available to Luxembourg";[256]
- "Luxembourg did not submit to the Commission any transfer pricing report prepared by Amazon in support of the transfer pricing arrangement in the ruling request approved by the contested tax ruling, although it was requested to do so";[257]
- "The Commission has doubts whether the Luxembourgish tax authorities properly confirmed by the contested tax ruling that the transfer pricing arrangement presented in Amazon's ruling request reflected what a prudent independent operator acting under normal market conditions would have accepted";[258]
- The method proposed by Amazon's PwC tax advisor in the tax ruling:[259]

  "…. does not seem to correspond to any of the methods listed in the OECD guidelines, described in recitals (13) and (14) above. While those methods are not exhaustive, the Commission has doubts, particularly in the absence of a transfer pricing report, whether the Luxembourgish tax authorities properly confirmed that the transfer pricing arrangement presented in Amazon's ruling request was in line with market conditions"; and
- As Lux SCS does not have a permanent establishment in Luxembourg and is therefore not subject to taxation, "if the royalty is exaggerated, it would unduly reduce the tax paid by Amazon in Luxembourg by shifting profits to an untaxed entity from the perspective of corporate taxation"[260]

It is worthy of note that PwC was criticised by the EC for putting forward a method that, in the opinion of the EC, did not fit with OECD guidelines.

[252] European Commission, 'Alleged aid to Amazon – Luxembourg', 7 October 2014, Brussels, SA.38944, p. 12.
[253] European Commission, 'Alleged aid to Amazon – Luxembourg', 7 October 2014, Brussels, SA.38944, p. 12.
[254] European Commission, 'Alleged aid to Amazon – Luxembourg', 7 October 2014, Brussels, SA.38944, p. 12.
[255] European Commission, 'Alleged aid to Amazon – Luxembourg', 7 October 2014, Brussels, SA.38944, p. 13.
[256] European Commission, 'Alleged aid to Amazon – Luxembourg', 7 October 2014, Brussels, SA.38944, p. 13.
[257] European Commission, 'Alleged aid to Amazon – Luxembourg', 7 October 2014, Brussels, SA.38944, p. 16.
[258] European Commission, 'Alleged aid to Amazon – Luxembourg', 7 October 2014, Brussels, SA.38944, p. 16.
[259] European Commission, 'Alleged aid to Amazon – Luxembourg', 7 October 2014, Brussels, SA.38944, pp. 16-17.
[260] European Commission, 'Alleged aid to Amazon – Luxembourg', 7 October 2014, Brussels, SA.38944, p. 18.

Overall, the EC established that the transfer pricing arrangement between Amazon and Luxembourg tax authorities by the contested tax ruling effectively contains a cap on remuneration which seems too low.[261] Furthermore the contested tax ruling was granted in 2003 but still in force as of June 2014, meaning that the remuneration accepted in the ruling was still being considered at arm's length by Luxembourg authorities more than ten years later, without any revision.[262] The EC was of the opinion that the Amazon tax ruling did not comply with the arm's length principle, and therefore that Luxembourg authorities gave an advantage to Amazon, which was "obtained every year and on-going".[263]

34.3.3. Apple

In March 2014, *The Australian Financial Review* reported that Apple had shifted an estimated $8.9 billion in untaxed profits from its Australian operations to a secrecy jurisdiction structure in Ireland.[264] The newspaper reported that in 2013 Apple reported pre-tax earnings in Australia of only $88.5 million after it sent an estimated $2 billion of income from its Australian sales to Ireland via Singapore, where Apple negotiated a secret tax deal in 2009.[265]

The Australian Financial Review reported that it obtained 10 years worth of financial accounts for Apple Sales International, the secretive Irish company at the heart of Apple's international tax arrangements, which revealed the mark-up Apple charges for intellectual property on its products around the world.[266]

The newspaper reported that Apple Sales International reported more than $112 billion of profits in the last five years. Its accounts show it has paid less than 50 cents in tax on every $1,000 of income.[267]

Apple Sales International was reported to extract the bulk of Apple's profits on sales outside of the US, which it claims as payments for intellectual property and intangibles.[268] But, it was further reported, the Irish-domiciled company has never filed its financial returns with the Companies Registrations Office in Dublin.[269]

It was stated that since 2003, Apple Sales International had not filed any financial reports at all in Ireland.[270]

The Australian Financial Review reported that in the four years from 2010 to 2013 Apple's Australian arm, Apple Pty Ltd, reported to ASIC total sales of $20 billion and pre-tax profits of $387 million.[271] *The Australian Financial Review* analysis shows that Apple's Australian arm paid an estimated $7.2 billion in profits to Apple Sales International in Ireland for "intangibles"

[261] European Commission, 'Alleged aid to Amazon – Luxembourg', 7 October 2014, Brussels, SA.38944, p. 20.
[262] European Commission, 'Alleged aid to Amazon – Luxembourg', 7 October 2014, Brussels, SA.38944, p. 20.
[263] European Commission, "Alleged aid to Amazon – Luxembourg", 7 October 2014, Brussels, SA.38944, p. 20.
[264] Neil Chenoweth, 'Apple's $9bn profit shift', *The Australian Financial Review,* 6 March 2014, p. 1.
[265] Neil Chenoweth, 'Apple's $9bn profit shift', *The Australian Financial Review,* 6 March 2014, p. 1.
[266] Neil Chenoweth, 'Apple's $9bn profit shift', *The Australian Financial Review,* 6 March 2014, p. 1.
[267] Neil Chenoweth, 'Apple's $9bn profit shift', *The Australian Financial Review,* 6 March 2014, p. 1.
[268] Neil Chenoweth, 'Apple's $9bn profit shift', *The Australian Financial Review,* 6 March 2014, p. 14.
[269] Neil Chenoweth, 'Apple's $9bn profit shift', *The Australian Financial Review,* 6 March 2014, p. 14.
[270] Neil Chenoweth, 'Apple's $9bn profit shift', *The Australian Financial Review,* 6 March 2014, p. 14.
[271] Neil Chenoweth, 'Apple's $9bn profit shift', *The Australian Financial Review,* 6 March 2014, p. 14.

over the same time frame.[272] (Apple Sales International reports marketing, research and other expenses in Ireland).[273]

The newspaper reported that in the period 2002 to 2013 Apple paid $193 million to the ATO in taxes.[274]

The newspaper reported that in 2012 an estimated $2.3 billion was diverted tax-free to Apple Sales International, and $2 billion in 2013.[275] It reported that in 2009, Apple Australia reported it paid $1.78 billion to Apple Sales International for Apple products.[276] Apple Sales International reported a 38.9% margin of that sale, which was reported to infer that $690 million of Apple Australia's payments for product went straight to Ireland, tax-free.[277] *The Australian Financial Review* reported that, in total, from 2002 to 2009, Apple Australia reported to ASIC that it paid $5.3 billion for Apple products, which suggested that $1.7 billion of this went untaxed to Ireland.[278]

Apple Sales International's 2009 accounts were reported to have stated: "The company is not tax resident in any jurisdiction … The average tax rate for all jurisdictions in which it operates is approximately 4 per cent."[279] In the ASIC filings the company is reported to have disclosed pre-tax earnings outside of the US of US$4 billion in 2009.[280] At a tax rate of 4%, that would have meant US$160 million in taxes paid, but the accounts were reported to show the actual tax paid was only US$3.65 million.[281]

The Australian Financial Review reported that the US Senate's Committee on Homeland Security and Government Affairs, Permanent Subcommittee on Investigations reported in May 2013 that:[282]

> *ASI [Apple Sales International] purchase[d] the finished goods from the manufacturer in China and then resold them to an Apple retail store in Australia, with ASI taking ownership of the products while in transit to Australia, then reselling them at a substantial profit to the Apple retail entity upon arrival.*

The margin that ASI charges on those resales to Australia and elsewhere is the entrepreneurial profit Apple charges for its intellectual property from research and development.[283]

According to the newspaper, in 2009 Apple Sales International's accounts filed with ASIC show it paid US$7.5 billion ($8.4 billion) to Chinese manufacturers who build Apple's products, before turning around to resell these products to Apple subsidiaries in Australia

[272] Neil Chenoweth, 'Apple's $9bn profit shift', *The Australian Financial Review,* 6 March 2014, p. 14.
[273] Neil Chenoweth, 'Apple's $9bn profit shift', *The Australian Financial Review,* 6 March 2014, p. 14.
[274] Neil Chenoweth, 'Apple's $9bn profit shift', *The Australian Financial Review,* 6 March 2014, p. 14.
[275] Neil Chenoweth, 'Apple's $9bn profit shift', *The Australian Financial Review,* 6 March 2014, p. 14.
[276] Neil Chenoweth, 'A hunt for pieces of Apple's pie', *The Australian Financial Review,* 6 March 2014, p.15.
[277] Neil Chenoweth, 'A hunt for pieces of Apple's pie', *The Australian Financial Review,* 6 March 2014, p.15.
[278] Neil Chenoweth, 'A hunt for pieces of Apple's pie', *The Australian Financial Review,* 6 March 2014, p.15.
[279] Neil Chenoweth, 'Apple's $9bn profit shift', *The Australian Financial Review,* 6 March 2014, p. 14.
[280] Neil Chenoweth, 'Apple's $9bn profit shift', *The Australian Financial Review,* 6 March 2014, p. 14.
[281] Neil Chenoweth, 'Apple's $9bn profit shift', *The Australian Financial Review,* 6 March 2014, p. 14.
[282] Neil Chenoweth, 'A hunt for pieces of Apple's pie', *The Australian Financial Review,* 6 March 2014, p.15.
[283] Neil Chenoweth, 'A hunt for pieces of Apple's pie', *The Australian Financial Review,* 6 March 2014, p.15.

and other countries for US$12.3 billion.[284] It was reported Apple Sales International pocketed the US$4.8 billion price mark-up as its gross operating profit, which is its gross margin.[285]

The Australian Financial Review reported that Apple Sales International and its parent, Apple Operations International, paid no tax in Ireland, according to Irish law, because they are managed and controlled in California.[286] It was reported they pay no US tax either because US law disregards where a company is managed and only looks at where a company is legally registered.[287]

The newspaper stated that none of the profits which Apple moves to Ireland from Australia and elsewhere were taxable.[288] At the time the Irish Government was moving to close the “double-non-taxation” loophole, but the new laws still allowed Apple to choose where its tax residence is – for example Bermuda, which has no corporate tax, or Singapore.[289] From 2010 Apple began re-routing its sales to Australia from Apple Sales International via a new Singapore subsidiary, Apple South Asia Pte Ltd.[290]

It was reported that Apple South Asia’s 2011 accounts note that on 24 March 2010, the company was granted a 10-year development and expansion incentive under which income would be taxed at 5% instead of the 17% rate in Singapore.[291] The newspaper reported that this was then renegotiated even further, with Apple to be taxed “at various concessionary rates.”[292]

The Australian Financial Review stated that despite the tax deal in Singapore, Apple South Asia reported only 1% of its $15 billion turnover as profit. Singapore was still only a way station as the profits headed for Ireland.[293]

Apple’s response to *The Australian Financial Review* was reported to be “We are compliant in Australia [with tax] and we are certainly compliant in Singapore as well, which is the Apple South Asia Pte Ltd company.”[294]

It was further reported that Apple stated its transfer pricing method has been formally confirmed and agreed by the Australian Taxation Office under an Advanced Pricing Agreement.[295]

At the end of September 2014 the EU released a preliminary finding that the Irish government had provided illegal state aid to Apple, through tax agreements it granted in 1991 and 2007.[296]

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[284] Neil Chenoweth, ‘A hunt for pieces of Apple’s pie’, *The Australian Financial Review,* 6 March 2014, p.15.
[285] Neil Chenoweth, ‘A hunt for pieces of Apple’s pie’, *The Australian Financial Review,* 6 March 2014, p.15.
[286] Neil Chenoweth, ‘Apple’s $9bn profit shift’, *The Australian Financial Review,* 6 March 2014, p. 14.
[287] Neil Chenoweth, ‘Apple’s $9bn profit shift’, *The Australian Financial Review,* 6 March 2014, p. 14.
[288] Neil Chenoweth, ‘Apple’s $9bn profit shift’, *The Australian Financial Review,* 6 March 2014, p. 14.
[289] Neil Chenoweth, ‘Apple’s $9bn profit shift’, *The Australian Financial Review,* 6 March 2014, p. 14.
[290] Neil Chenoweth, ‘Apple’s $9bn profit shift’, *The Australian Financial Review,* 6 March 2014, p. 14.
[291] Neil Chenoweth, ‘Apple’s $9bn profit shift’, *The Australian Financial Review,* 6 March 2014, p. 14.
[292] Neil Chenoweth, ‘Apple’s $9bn profit shift’, *The Australian Financial Review,* 6 March 2014, p. 14.
[293] Neil Chenoweth, ‘Apple’s $9bn profit shift’, *The Australian Financial Review,* 6 March 2014, p. 14.
[294] Neil Chenoweth, ‘A hunt for pieces of Apple’s pie’, *The Australian Financial Review,* 6 March 2014, p.15.
[295] Neil Chenoweth, ‘Tax me if you can’, *The Australian Financial Review*, 7 March 2014.
[296] Neil Chenoweth, ‘EU calls Apple tax deal illegal’*, The Australian Financial Review*, 2 October 2014.

The Age reported that Apple paid $80.3 million in Australian tax in 2014, on more than $6 billion in local revenue, according to accounts filed with the corporate regulator.[297] However, *The Age* went on to report that an Apple spokeswoman declined to comment on whether the accounts reflected tax paid accurately.[298]

The Australian Financial Review also reported that more than two-thirds of Apple's iTunes earnings outside North America are not taxable in the group's Luxembourg holding company, thanks to an intra-group fees arrangement signed in 2008.[299]

Most of Apple's revenues from the sale of music and films outside the US flow to a Luxembourg holding company, iTunes Sarl.[300]

Turnover for iTunes Sarl increased from €353 million ($508 million) in 2009 to €2.05 billion in 2013. Secret appendices to the 2011 accounts break down some of Apple's costs. It shows that Apple takes a third of iTunes revenues as its gross profit margin. The 2011 figures showed that a flat 50 per cent of this gross profit was paid in intercompany charges. "On September 28 2008, the company entered into a marketing services agreement with an affiliated company," iTunes Sarl reported in 2009. This is separate from the marketing costs that iTunes pays to third parties.[301]

The related-party charges account for 66 per cent of earnings for iTunes Sarl, which nevertheless earned €90 million of taxable income in 2011, and paid €26.6 million tax to Luxembourg. By 2013, however, despite a doubling in sales, tax dropped to €20 million.[302]

34.3.4. Publishing and Broadcasting Limited

The Australian Financial Review has reported on a secret deal with the Swiss government negotiated by media group Publishing and Broadcasting Limited to set a tax rate of less than 2.15 per cent on PBL's intra-company loans.[303]

The newspaper stated that neither PBL nor Crown have ever detailed the activities of the 35 subsidiaries PBL Securities set up in tax havens, a process that started in 1996.[304]

The newspaper also stated that while PBL's accounts showed subsidiaries in the Cayman Islands, the Bahamas, the Netherland Antilles, Cyprus, Mauritius and Luxembourg, it made no reference to operations in Switzerland.[305]

As Ernst & Young Swiss partner Markus Huber described it in correspondence in 1996, PBL's Swiss branch would on-lend money borrowed from banks to PBL group companies, apparently at a higher rate. It would make a profit on this exchange, so the issue was how much Swiss tax would be charged on that profit. "According to our model computations, the effective tax rate on the interest income should be below 1.65 per cent. Should the balance

[297] Georgia Wilkins, 'Apple's $80.3 million Australian tax bill revealed', *The Age*, 28 January 2015.
[298] Georgia Wilkins, 'Apple's $80.3 million Australian tax bill revealed', *The Age*, 28 January 2015.
[299] Neil Chenoweth, 'Apple's iTunes escape tax', *The Australian Financial Review*, 11 November 2014.
[300] Neil Chenoweth, 'Apple's iTunes escape tax', *The Australian Financial Review*, 11 November 2014.
[301] Neil Chenoweth, 'Apple's iTunes escape tax', *The Australian Financial Review*, 11 November 2014.
[302] Neil Chenoweth, 'Apple's iTunes escape tax', *The Australian Financial Review*, 11 November 2014.
[303] Neil Chenoweth, 'Secret tax pact of a young mogul', *The Australian Financial Review*, 16 December 2014.
[304] Neil Chenoweth, 'Secret tax pact of a young mogul', *The Australian Financial Review*, 16 December 2014.
[305] Neil Chenoweth, 'Secret tax pact of a young mogul', *The Australian Financial Review*, 16 December 2014.

sheet total the branch office be less than 400 million Swiss francs ($503 million), then based on our assumptions the effective tax rate should be less than approximately 2.15 per cent".[306]

The Australian Financial Review reported that PBL's June 1997 annual report showed a new offshore wing had been created. PBL Securities now had $210 million invested in Publishing & Broadcasting International Holdings in the Bahamas.[307] The Bahamas company had a subsidiary, PBL Capital (Malaysia) Sdn Bhd, which in turn had a Dutch subsidiary, PBL Financial Services BV, apparently the Dutch finance company described by Mr Huber.[308]

The newspaper reported that by 1999 capital invested in the Bahamas-Netherlands companies had grown to $410 million, with another $345 million in a new Cayman Islands company, PBL (CI) Limited.[309] By 2005, when PBL stopped listing its subsidiaries, PBL Securities had invested $1.1 billion in 34 subsidiaries.[310]

34.3.5. Chevron

Media reports indicate that ATO mounted legal action against Chevron in relation to inter-party loans dating back to 2004.[311] The loans were between Chevron Australia and its US parent company, Chevron Corporation, following a restructure of the company when it merged with Texaco in 2003. The loans were reported to have gone through an intermediary company called Chevron Funding Corporation, based in the US state of Delaware.[312]

The ATO has alleged that the energy corporation used a series of loans and related party payments to reduce its Australian tax bill by up to $258 million.[313] Documents filed in 2014 by the ATO show how the company allegedly used a complex scheme to benefit from the tax-free interest on inter-company loans between 2004 and 2008 in order to avoid tax.[314] Chevron is disputing the tax bill, which could run up to $322 million with penalties.[315]

Following a merger with Texaco in 2001 a new holding company, Chevron Australia Holdings Pty Ltd, was formed. Chevron Australia Pty Ltd, the company Chevron ran its Australian business through prior to the merger, became a subsidiary of the holding company.[316] Another subsidiary of the holding company, Chevron Funding Corporation, was also formed

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306 Neil Chenoweth, 'Secret tax pact of a young mogul', *The Australian Financial Review*, 16 December 2014.

307 Neil Chenoweth, 'Secret tax pact of a young mogul', *The Australian Financial Review*, 16 December 2014.

308 Neil Chenoweth, 'Secret tax pact of a young mogul', *The Australian Financial Review*, 16 December 2014.

309 Neil Chenoweth, 'Secret tax pact of a young mogul', *The Australian Financial Review*, 16 December 2014.

310 Neil Chenoweth, 'Secret tax pact of a young mogul', *The Australian Financial Review*, 16 December 2014.

311 Georgia Wilkins, ' ATO wait in Chevron avoidance court fight', *The Age,* 30 September, 2013.

312 Georgia Wilkins, ' ATO wait in Chevron avoidance court fight', *The Age,* 30 September, 2013.

313 Georgia Wilkins, 'ATO alleges complex Chevron scheme slashed tax bill by $258m', *The Sydney Morning Herald,* 9 October 2014, http://www.smh.com.au/business/ato-alleges-complex-chevron-scheme-slashed-tax-bill-by-258m-20141008-113696.html

314 Georgia Wilkins, 'ATO alleges complex Chevron scheme slashed tax bill by $258m', *The Sydney Morning Herald,* 9 October 2014, http://www.smh.com.au/business/ato-alleges-complex-chevron-scheme-slashed-tax-bill-by-258m-20141008-113696.html

315 Georgia Wilkins, 'ATO alleges complex Chevron scheme slashed tax bill by $258m', *The Sydney Morning Herald,* 9 October 2014, http://www.smh.com.au/business/ato-alleges-complex-chevron-scheme-slashed-tax-bill-by-258m-20141008-113696.html

316 Malcolm Maiden, 'Tied up in knots over Chevron', *The Sydney Morning Herald,* Business section, 9 October 2014, p. 21.

in Delaware, a US secrecy jurisdiction. It is reported that Chevron Funding Corporation allegedly raised money in the US commercial market and then advanced $US2.4 billion (borrowed at a rate of 1.2 per cent) to Chevron Australia Holdings Pty Ltd, its parent company, at an interest rate of 9 per cent.[317] The ATO alleges that as the holding company repaid the $2.5 billion debt (loan plus interest), Chevron Funding Corporation booked profits and claimed tax deductions, which were then returned to the holding company in the form of tax-free dividends.[318] According to the ATO, the interest payments on the debt were tax-deductible, and "the higher the interest rate on the loan from Chevron Funding Corporation the greater the arbitrage, which was not subject to tax in either the US or Australia".[319] The scheme is alleged to have given Chevron up to $862 million in tax-free dividends over five years.[320] The ATO confronted Chevron Australia Holdings with a $268 million tax bill in 2010 following an audit.[321] The ATO is after $212 million and $258 million in tax and between $64 million and $21 million in penalties, depending on the arm's length interest rate that is used.[322]

In its Federal Court submission, Chevron argues that the ATO claims are invalid, and that the arm's length consideration for the loan between Chevron Funding Corporation and its parent holding company would have been no less than the amount paid, and profit shifting did not occur.[323] The ATO is alleging that senior executives at the corporation's US operations approved the loans with full knowledge that they would only benefit the company for tax purposes.[324] Documents filed in 2014 claim that Chevron's US treasurer Dave Krattebol suggested the Australian subsidiary incur a $2.5 billion debt to create "the most tax efficient corporate capital structure".[325] The ATO also alleges that the company created Chevron Funding Corporation in Delaware for the "sole function"[326] of giving loans to the Australian subsidiary: "It had no business activities other than raising funds … for the benefit of [Chevron Australia]".[327] Chevron launched an appeal in 2012 and the case is now being heard in the Federal Court.

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[317] Malcolm Maiden, 'Tied up in knots over Chevron', *The Sydney Morning Herald,* Business section, 9 October 2014, p. 21.
[318] Malcolm Maiden, 'Tied up in knots over Chevron', *The Sydney Morning Herald,* Business section, 9 October 2014, p. 21.
[319] Malcolm Maiden, 'Tied up in knots over Chevron', *The Sydney Morning Herald,* Business section, 9 October 2014, p. 21.
[320] Georgia Wilkins, 'ATO alleges complex Chevron scheme slashed tax bill by $258m', *The Sydney Morning Herald,* 9 October 2014, http://www.smh.com.au/business/ato-alleges-complex-chevron-scheme-slashed-tax-bill-by-258m-20141008-113696.html
[321] Georgia Wilkins, 'ATO alleges complex Chevron scheme slashed tax bill by $258m', The *Sydney Morning Herald,* 9 October 2014, http://www.smh.com.au/business/ato-alleges-complex-chevron-scheme-slashed-tax-bill-by-258m-20141008-113696.html
[322] Malcolm Maiden, 'Tied up in knots over Chevron', *The Sydney Morning Herald,* Business section, 9 October 2014, p. 21.
[323] Malcolm Maiden, 'Tied up in knots over Chevron', *The Sydney Morning Herald,* Business section, 9 October 2014, p. 21.
[324] Georgia Wilkins, 'ATO alleges complex Chevron scheme slashed tax bill by $258m', *The Sydney Morning Herald,* 9 October 2014, http://www.smh.com.au/business/ato-alleges-complex-chevron-scheme-slashed-tax-bill-by-258m-20141008-113696.html
[325] Georgia Wilkins, 'ATO alleges complex Chevron scheme slashed tax bill by $258m', *The Sydney Morning Herald,* 9 October 2014, http://www.smh.com.au/business/ato-alleges-complex-chevron-scheme-slashed-tax-bill-by-258m-20141008-113696.html
[326] Georgia Wilkins, 'ATO alleges complex Chevron scheme slashed tax bill by $258m', *The Sydney Morning Herald,* 9 October 2014, http://www.smh.com.au/business/ato-alleges-complex-chevron-scheme-slashed-tax-bill-by-258m-20141008-113696.html
[327] Georgia Wilkins, 'ATO alleges complex Chevron scheme slashed tax bill by $258m', *The Sydney Morning Herald,* 9 October 2014, http://www.smh.com.au/business/ato-alleges-complex-chevron-scheme-slashed-tax-bill-by-258m-20141008-113696.html

34.3.6. Google

Media reports have raised concerns about the lack of tax paid by Google in Australia. It was reported that in May 2013, Google received a $12.7 million tax deduction for research and development in 2012, about three times the amount it paid in taxes.[328]

Google Australia, the US company's local arm, was reported to have had a profit of $22.4 million in the 2012, its first profit in the four previous years.[329] The profit was reported to attract a tax obligation of $4.2 million, up from $74,176 the year before.[330] The 2012 result was subsequently revised in the 2013 financial statements to a profit before tax of $26.6 million while a tax credit of $4.7 million now boosts the 2012 after tax result to $31.3 million.[331]

This submission in relation to Google has quoted tax expense as the relevant value for each year. Tax expense represents the net amount of tax that Google Australia will ever pay in respect of each such year, regardless of the timing of cash payments and credits that make up the net amount. The tax expense calculation recognises the different treatments between taxable income and accounting income in each year (mainly of unpaid provisions for expense and tax versus accounting depreciation). As a result, tax expense recognises that the different treatments will result in timing differences where either cash paid or payable now to the ATO now will be claimed back at a later date or cash paid and or payable now is less than the total tax expense and the balance is deferred to a later date.

Following a number of press articles that were critical of Google Australia's lack of tax contributions, Google Australia stated it paid $7.1 million in tax in 2013.[332] This statement is at odds with the company's own audited financial statements lodged with ASIC which reveal that Google Australia have only admitted to a tax expense obligation of only $0.467million for 2013 on a profit of $46.5million.[333] An effective tax rate of 1%. *The Age* reported that the company initially received a tax bill of $7.1 million for the year ending December 2013, but only $466,802 would be paid following a series of deductions.[334]

The Google spokesman also declined to comment on the tax expense figure, but said the company had paid $7.1 million in corporate taxes "and $15 million in payroll and other taxes in Australia as part of our investment in a local workforce of over 900 people".[335]

The Age put estimates of its Australian advertising revenue as high as $2 billion. Its profits in Australia rose to $46 million in 2013 from $26 million a year earlier.

Looking deeper into the tax expense calculation in the notes, Google Australia's figure of $7.1 million was their estimate of the cash payment they expected to make in respect of 2013 as a current liability.[336] Google failed to mention that they also expected to get $6.6

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[328] Georgia Wilkins, 'Need a tax deduction? Just Google it', *The Age,* 2 May 2013, p. 31.
[329] Georgia Wilkins, 'Need a tax deduction? Just Google it', *The Age,* 2 May 2013, p. 31.
[330] Georgia Wilkins, 'Need a tax deduction? Just Google it', *The Age,* 2 May 2013, p. 31.
[331] Georgia Wilkins, 'Need a tax deduction? Just Google it', *The Age,* 2 May 2013, p. 31.
[332] Michael West, 'Search to unearth Google Australia directors returns 'o'', *The Sydney Morning Herald,* 30 June 2014; and Alex Heber, 'Google Australia Boss Maile Carnegie Says Tax System Needs To Be Fixed', http://www.businessinsider.com.au, 1 July 2014.
[333] Google Australia Pty Ltd 2013 Financial Statements, ASIC, Statement of Comprehensive Income; and Georgia Wilkins and Ben Butler, 'Google pays $460,000 in tax on its $46m profit', *The Age*, 2 May 2014.
[334] Georgia Wilkins and Ben Butler, 'Google pays $460,000 in tax on its $46m profit', *The Age*, 2 May 2014.
[335] Georgia Wilkins and Ben Butler, 'Google pays $460,000 in tax on its $46m profit', *The Age*, 2 May 2014.
[336] Google Australia Pty Ltd 2013 Financial Statements, ASIC, Note 6 Income Tax Expense.

million of that back in future years when deductions for accounting purposes are later allowed for tax.[337]

Despite Google's claim that the $7.1 million had been paid, its own accounts state that by year end the whole amount had in fact not been paid. Their balance sheet reveals a zero opening balance for amounts owed to the ATO at the beginning of 2013. To that they added their $7.1 million estimate of current liability in respect of 2013. They also stated that as at the end of 2012 they were expecting the ATO to give them back $2.9 million, but the balance of the $7.1 million remaining unpaid at year end was still $3.8million. There was one small adjustment made to the current estimate, but perhaps they got a little more back from the ATO than they originally expected to arrive at the final balance owing as reported in the 2013 balance sheet.[338]

The available evidence is indicating that Google Australia did not make the claimed payment of $7.1million to the ATO (either gross or net) that they quoted to the press. Their own accounts indicate that in 2013 they actually got back in cash more than they paid in cash.

The financial statements of Google Australia state that the company is dependent, for its service revenues on Google Asia Pacific Pte. Ltd (GAP)(Singapore), Google Ireland Limited (GIL)(Ireland) and Google Inc (The US Parent). This arrangement is only guaranteed for 12 months from the date of signing the report.[339]

The Age reported that Google Australia subsists on services income from its head office in the US and subsidiaries in Singapore and Ireland. Much of the search engine's local advertising revenue is collected by the Singapore subsidiary, Google Asia Pacific.[340]

In contracting with the Google organisation, Australians are invoiced by GAP in Singapore, not Google Australia. Google Australia's accounts indicate that they do not receive any revenue directly from Australians. Its financial statements disclose that its sole source of revenue is from services provided to offshore Google companies, including its ultimate parent Google Inc. which has direct control of which revenues are contracted to Google Australia.[341]

Turning now to statements made by Google Australia's ultimate parent company, Google Inc, the financial information disclosed in Google Inc.'s 2013 Form 10F, prepared for its SEC filing requirements, does not include disclosure of the percentage of revenue or profit that the group sourced from Australia.[342] The Form does however disclose that 45% of its revenue is sourced from the US, so with the addition of some comparative data from the public domain it is still possible to estimate Google's Australian sourced income on which it paid no Australian tax.[343]

As a back of the envelope calculation, Australia's population is approximately 7.2% of the US (22.7million versus 313.9million). The GDP per capita of both countries in 2013 was

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[337] Google Australia Pty Ltd 2013 Financial Statements, ASiC, Note 6 Income Tax Expense.
[338] Google Australia Pty Ltd 2013 Financial Statements, ASIC.
[339] Google Australia Pty Ltd 2013 Financial Statements, ASIC, Note 2(s) Economic Dependency
[340] Georgia Wilkins and Ben Butler, 'Google pays $460,000 in tax on its $46m profit', *The Age*, 2 May 2014.
[341] Google Australia Pty Ltd 2013 Financial Statements, ASIC, Note 2(s) Economic Dependency
[342] Extracts from US Securities & Exchange Commission Form 10F filing available on Google Inc.'s website.
[343] Extracts from US Securities & Exchange Commission Form 10F filing available on Google Inc.'s website.

approximately the same (A$44,000 versus US$46,000). Assuming spending patterns and spending per capita on Google services are likely to have been similar, then based on the consolidated revenues disclosed in Google Inc.'s financial statements, one could assume that Google Inc.'s consolidated revenues from Australian sources are likely to be around A$2 billion (that is 7.2% of 45% of US$59.8 billion).[344] Some estimates in the Australian press have been slightly higher, but the source and /or basis of these estimates is unknown.

Applying the same formulae to Google Inc.'s US$14 billion[345] consolidated profit before tax, one might then expect that Google Inc.'s consolidated net profit before tax from Australian sourced income, was close to A$450 million. If that profit had been taxed at source in Australia, this would have caused Google to contribute around A$135 million in 2013 as tax expense to the Australian government. This compares to the $4.3 million tax credit Google Inc secured through Google Australia in 2012 and the $0.467 million tax expense Google Australia declared for 2013.[346]

Google's Australian advertising business continues to grow. Its corresponding tax obligation is also expected to grow but will continue to be forgone by the Australian Government.

Google will no doubt claim it is invalid to apply this estimated percentage contribution, based on gross revenue, to their consolidated after tax result, probably claiming it does not allow for costs that GAP incurs in deriving its Australian revenue. However, GAP's results include the effect of Google Inc doing business with itself by directing GAP to engage in Google's artificial internal transfer pricing arrangements.

The consolidated accounts eliminate Google's internal profit shifting, so the same percentage applied to Google Inc's consolidated income before tax will likely be more representative of the tax contributions that Australia has forgone in total due to Google's tax dodging arrangements.

Google Australia claims to be a Research & Development centre, but it also employs people who appear to have responsibilities for marketing in Australia and New Zealand. Google Australia claimed to have 908 employees in Australia as at the end of 2013[347] of which it has stated that 450 are engineers.[348]

In June 2014, *The Age* reported that the person Google Australia publicly calls its "managing director", Maile Carnegie, is not actually a director of any Google entity, according to corporate database searches. Ms Carnegie had never been registered with any Google entity on the ASIC database.[349]

Google Australia declares itself to be a Large Proprietary company that is not a Disclosing Entity. It also claims there are no users dependent on general purpose financial reports, so it only produces special purpose accounts that are of limited use for purposes of determining whether or not Google Australia is meeting its Australian tax obligations. It is also impossible, from the limited disclosures in these accounts, to estimate the extent to which Google

[344] Extracts from US Securities & Exchange Commission Form 10F filing available on Google Inc.'s website.
[345] Extracts from US Securities & Exchange Commission Form 10F filing available on Google Inc.'s website.
[346] Google Australia Pty Ltd 2013 Financial Statements, ASIC, Statement of Comprehensive Income.
[347] ASIC Form 388, Google Australia Pty. Ltd., Details of Large Proprietary Company.
[348] Reissa Su, 'Google Inc Australia Accused of Paying Less Than $500,000 in tax despite 46.5 Million Profit', *International Business Times*, 2 May 2014; and Paul Smith, 'Tech has left tax systems behind, says Google', *The Australian Financial Review,* 12 June 2014.
[349] Michael West, 'Google stonewall, even at street view', *The Age*, 30 June 2014.

Australia is being paid to assist GAP in providing services to Australians (and New Zealanders) or in assisting GAP to run other aspects of its business in Australia (and New Zealand), including the provision of assistance to GAP's Agents in Australia (which Google describe as Resellers) who appear to work exclusively for GAP rather than act as general agents. One must question whether or not the combination of these arrangements has the potential to classify GAP's resellers as employees of GAP under Australian law.

The combination of GAP reseller's exclusive agencies in Australia (if not actually employees at law) and the services that Google Australia appear to provide to GAP through persons located in Google Australia's Sydney offices may be sufficient to constitute a permanent establishment for GAP in Australia, but without the ATO's ability to question Google Australia, it is impossible to tell whether or not GAP does or does not have such a permanent establishment. Should GAP be declaring branch operations in Australia through a permanent establishment that it shares with Google Australia as its agent and should it in fact be paying tax in Australia on its estimated profit of almost half a billion dollars that is sourced from Australia?

34.3.7. Kraft, Suzuki, Alcoa, Hilton, Hertz, Sony, Nike and Fujitsu

The Australian reported on a confidential list compiled by IBISWorld, a research firm, about which multinational companies operating in Australia were paying the lowest levels of tax. It found Kraft Australia had the lowest level of tax paying. In 2011, Kraft collected a $6.6m tax refund despite recording a gross profit of $102m on revenue of $1.9bn. A company spokesman told *The Australian* that result was "an abnormal tax impact due to Kraft Foods' acquisition of Cadbury in 2011".[350]

The Australian reported that Suzuki Australia generated sales of $425 million but paid just $399,000 in tax. The company declined to return calls from the newspaper about the finding.[351]

The Australian reported that Alcoa, Hilton and Hertz were among the companies that reported very low tax payments in the IBISWorld report.[352] *The Australian* also reported that while Google has been in the spotlight for tax minimisation, its tax compliance appeared to be better than that of Sony, Nike and Fujitsu.[353]

34.4. Measures to combat Multinational Corporate Tax Dodging

The Synod welcomes the existing areas of focus for the ATO:

- addressing tax avoidance, particularly base erosion and profit shifting (BEPS);
- promoting international tax transparency by sharing bank and financial information between jurisdictions;
- building a tax development program to ensure low-income countries can receive their fair share of tax; and
- building collaboration among tax administrations.[354]

The ATO has acknowledged "It may be that the existing law is not sufficient to achieve the G20 goal of ensuring that 'Profits should be taxed where the economic activities deriving the profits are performed and where value is created.'"[355]

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350 Paul Cleary, 'Global giants duck $100m tax bill', *The Australian,* 9 May 2014.
351 Paul Cleary, 'Global giants duck $100m tax bill', *The Australian,* 9 May 2014.
352 Paul Cleary, 'Global giants duck $100m tax bill', *The Australian,* 9 May 2014.
353 Paul Cleary, 'Global giants duck $100m tax bill', The Australian, 9 May 2014.
354 Australian Taxation Office, '*ATO Annual Report 2013-14',* 2014.

The Synod notes progress is being made in tackling cross-border tax evasion and tax avoidance, both by individuals and MNEs. For example, in July 2014 the OECD revealed that at least €37 billion ($53 billion) of tax had been collected by governments across the world from secret offshore accounts since 2009.[356] While such action targeted individuals, it shows that progress can be made where there is the political will to do so by a majority of governments.

34.4.1. The Need for Multilateral Action

While it is recognised that jurisdictions have sovereignty to design tax laws and to raise revenue in accordance with the needs of its citizens The Synod is of the view that measurable outcomes require a significant degree of cooperation and consensus from all nations. We recognise that the ATO and Federal Government are collaborating with other administrations and organisations to achieve a global solution. We encourage the Federal Government to go further than simply cooperating with other jurisdictions to consider how the concept of fiscal sovereignty and tax competition is relied upon as a defence against true international cooperation and collaboration.

Tax sovereignty is one of the challenges that will be faced in any proposed solution to corporate tax avoidance. However, base erosion and profit shifting is of itself a threat to tax sovereignty, and as such, jurisdictions will need to adopt a more collaborative approach. There is a significant difference to the way nation states operate and the way multinational corporations operate. Nation states have ultimately come to compete against each other for a share of a finite amount of the fiscal pie, whereas separately located parts of a multinational entity do not compete against each other but rather operate under a common vision of maximizing net returns.[357] Ultimately, this difference occurs because the two fundamental concepts, the norms of residency and source which have been developed over the decades, and despite their age, continue to apply to modern multinational entities to allocate income to a specific jurisdiction.[358] The result of the disconnect between the objective of multinational entities being a common goal of wealth maximization for themselves, as compared to the objective of nation states to secure their share of tax dollars, and the resultant international tax regime, means that multinational entity income is neither being taxed in the source jurisdiction nor the residence jurisdiction.

A former Assistant Treasurer pointed out "left unchecked, profit shifting and international tax avoidance is a threat to Australia's sovereignty. It is a threat to our sovereign right to tax and to raise the revenue necessary to provide the public goods and services our society requires."[359] Australia needs to exercise its sovereignty to raise the necessary revenue for its own citizens without the ability of multinational entities to erode that base in any way. Consequently, sovereignty will play a substantive role in any international tax reform debate. However, it should not be seen as an impediment to a move towards a more globalised regime designed to prevent base erosion and profit shifting.

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[355] Mark Konza, 'Global tax avoidance and its effects on Australia's economic prosperity', Sydney, ATO Media Centre, 26 August 2014, https://www.ato.gov.au/Media-centre/Speeches/Other/Global-tax-avoidance-and-its-effects-on-Australia-s-economic-prosperity/

[356] Vanessa Houlder, 'Crackdown on secret accounts yields $53bn', *Financial Times*, 23 July 2014.

[357] Kerrie Sadiq "A Nation's Role in Addressing Base Erosion and Profit Shifting: Sovereignty in Relation to Transfer Pricing" (2013) 19 *New Zealand Journal of Taxation Law and Policy* 343.

[358] Kerrie Sadiq "A Nation's Role in Addressing Base Erosion and Profit Shifting: Sovereignty in Relation to Transfer Pricing" (2013) 19 *New Zealand Journal of Taxation Law and Policy* 343.

[359] David Bradbury, MP, "Stateless Income – A Threat to National Sovereignty" *Address to the Tax Institute of Australia's 28th National Convention*, 15 March 2013.

Thus, to address tax dodging and tax avoidance by multinational corporations international co-operation is needed, both in the design of the international tax system and in the conduct of enforcement action by tax authorities. As stated by the OECD: [360]

> *Because many BEPS strategies take advantage of the interface between the tax rules of different countries, it may be difficult for any single country, acting alone, to fully address the issue. Furthermore, unilateral and uncoordinated actions by governments responding in isolation could result in the risk of double – and possibly multiple – taxation for business. This would have a negative impact on investment, and thus on growth and employment globally. In this context, the major challenge is not only to identify appropriate responses, but also the mechanisms to implement them in a streamlined manner, in spite of the well-known existing legal constraints, such as the existence of more than 3,000 bilateral tax treaties. It is therefore essential that countries consider innovative approaches to implement comprehenisve solution.*

The Prime Minister, The Hon Tony Abbott, has acknowledged the importance of international cooperation in combating cross-border tax avoidance by MNEs, stating that while the ATO was "always looking to try to protect the revenue. But plainly it helps if all other major jurisdictions are doing likewise."[361]

The Treasurer, The Hon Joe Hockey, has also publicly acknowledged the importance of collaboration between tax authorities to deal with cross-border tax evasion and avoidance stating on 8 October 2014 "the G20 has, for the first time, supported cooperation among our tax authorities on compliance activities, which will be a key element in enforcing compliance and identifying tax risks."[362]

The ATO has also acknowledged the importance of international collaboration to deal with multinational corporate tax avoidance:[363]

> *There are two key reasons why it is important that consensus be reached. Firstly, a strong global view allows the G20 and OECD to pressure those countries who might want to continue to facilitate tax avoidance to stop that facilitation.*
>
> *Secondly, reaching a global view on improvements through the G20 and OECD reduces the possibility of unilateral action being taken by countries dissatisfied with the current international tax arrangements. Unilateral action could result in multiple tax systems operating around the world, increasing the risk of double taxation, compliance costs and further tax planning.*

The ATO has stated it has a focus on ensuring Australia gets its 'fair share' of international profit. A key part of this strategy continues to be engaging internationally with other administrations and organisations such as the OECD to influence global strategies, undertake joint compliance activities, share intelligence and develop best practice.

As stated by the Comissioner of Taxation in a speech given on 6 November 2014:[364]

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[360] OECD, 'Addressing Base Erosion and Profit Shifting', OECD Publishing, http://dx.doi.org/10.1787/9789264192744-en, 2013, p. 8.

[361] Phillip Coorey, 'Tax evasion hurts us all: Abbott', *The Australian Financial Review*, 13 November 2014.

[362] The Hon Joe Hockey, 'The path to Brisbane – Setting up the G20 to make a difference', Speech in Washington DC, 8 October 2014.

[363] Mark Konza, 'Global tax avoidance and its effects on Australia's economic prosperity', Sydney, ATO Media Centre, 26 August 2014, https://www.ato.gov.au/Media-centre/Speeches/Other/Global-tax-avoidance-and-its-effects-on-Australia-s-economic-prosperity/

[364] Chris Jordan, 'Commissioner's address to the Tax Bar Association', Melbourne, ATO Media Centre, 6 November 2014, https://www.ato.gov.au/Media-centre/Speeches/Commissioner/Commissioner-s-address-to-the-Tax-Bar-Association/

In today's world, multinationals operate seamlessly across borders and take a global, top-down view to structure their operations across countries for maximum economic advantage. As tax administrators, we need to do the same. We will remain at a disadvantage unless we move from taking an isolated, single country view and replace it with a global, bigger picture view.

We have stepped up our efforts to ensure that multinationals pay tax in Australia on the income they earn here. Working with the G20, OECD and other partner tax administrations, we have been mapping the global operations of some multinationals that operate in the digital economy. As a prototype for a new way of working together, Australia has led a project with five other countries to investigate global tax planning by multinationals and share intelligence on their activities.

This unprecedented collaboration is allowing us to better understand and compare financial reporting by multinationals in Australia with what they report in other countries. We are testing their assertions and arrangements as to how they fit with our existing laws.

In fact the ATO has stated "For the first time, multilateral co-operation and collaboration between tax administrations is becoming the norm of how we do business"[365], which is an extremely positive development.

The G20 Leaders' Summit communique from Brisbane in November 2014 stated "We welome further collaboration by our tax authorities on cross-border compliance activities."[366]

When other jurisdictions facilitate tax evasion and tax avoidance through providing secrecy to foreign entities, through failure to implement the Financial Action Task Force recommendations on anti-money laundering and counter terrorism financing and through allowing the use of shell companies, they also risk facilitating other forms of transnational crime and the funding of terrorism.[367] This is not in Australia's interests and is linked to MNE tax dodging.

The ATO has undertaken a very welcome regional initiative to strengthen links between 16 tax authorities within our region through the Study Group on Asian Tax Administration and Research (SGATAR). With SGATAR members account for 26.5% of world GDP - expected to increase to 35% by 2030 – the ATO recognises there is a greater need for the region's tax systems to be closely aligned and operating as efficiently as they can. The current SGATAR members include Australia, People's Republic of China, Hong Kong SAR, Indonesia, Japan, Republic of Korea, Macao SAR, Malaysia, Mongolia, New Zealand, Papua New Guinea, The Philippines, Singapore, Chinese Taipei, Thailand and Vietnam.[368]

The G20 Leaders' Summit communique from Brisbane in November 2014 promised that the G20 governments would work with developing countries "to build their tax administration

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[365] Mark Konza, 'Base erosion and profit shifting – a progress report on G20/OECD action', Melbourne, ATO Media Centre, 25 September 2014, https://www.ato.gov.au/Media-centre/Speeches/Other/BEPS---a-progress-report-on-G20/OECD-action/.

[366] G20 Leaders' Communique, Brisbane Summit, 15-16 November 2014, p. 2.

[367] See for example Emile van der Does de Willebois, Emily Halter, Robert Harrison, Ji Won Park and Jason Sharman, "Puppet Masters. How the Corrupt Use Legal Structures to Hide Stolen Assets and What to Do About It", World Bank and UNODC, 2011.

[368] Australian Taxation Office, 'Closer tax ties in the Asia-Pacific', ATO Media Centre, 21 November 2014, https://www.ato.gov.au/Media-centre/Media-releases/Closer-tax-ties-in-the-Asia-Pacific/

capacity and implement AEOI [automatic exchange of information]".[369] The Treasurer also made the same point in October 2014 stating:[370]

> *Tax avoidance and evasion are issues for everyone. That's why, this year, we also agreed to practical steps to help developing countries address base erosion and exchange tax information, including by facilitating the work of tax inspectors "without borders."*

However, the problems faced by developing countries from MNE tax avoidance are not simply a matter of capacity. The complexity of some of the rules the OECD has sought to impose as the global standard often drives what is then characterised as a capacity problem of the developing countries. Simpler global tax rules would go a significant way to reducing the alleged capacity deficit of developing countries.

The ATO has helped train tax officials in the Asia-Pacific region – including Papua New Guinea, Indonesia and China – to identify risk and audit multinational companies.The Commissioner of Taxation, Chris Jordan, stated that it was in Australia's interest to support other tax authorities as "The better the relationship we have with those authorities the better, quicker, easier exchange" of information occurs.[371]

34.4.2. Increased Transparency

Greater transparency around the tax affairs of MNEs is an important step in combating cross-border tax avoidance.

Increased transparency increases the pressure on MNEs to comply fully with their tax obligations. Increasingly, a sense of social responsibility is seen as important to large business and creates an expectation that company decision makers should also act in a broader social context in making business decisions. The appropriateness of aggressive tax planning and tax minimisation may be reappraised through the lens of corporate social responsibility as companies that do not pay their 'fair share of taxes' risk hostility from the public, and ultimately reputational damage.[372] This reputational risk is increased by greater transparency.[373]

As a small step towards greater transparency it would be desirable for ASX companies to have to disclose all their subsidiaries, regardless of size and materiality. In 2006 the UK Parliament passed a law that required FTSE 100 companies to disclose the location of *all* subsidiaries, regardless of their size or materiality. However, unfortunately the UK Companies House has failed to enforce the requirement.[374]

The Oxford University Centre for Business Taxation found that FTSE 100 firms that were exposed by ActionAid as not compliant with subsidiary disclosure rules (non-compliant firms) report higher effective tax rates (ETRs) following the public scrutiny. In the view of the Centre for Business Taxation this indicated a decrease in tax avoidance relative to FTSE 100 firms

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[369] G20 Leaders' Communique, Brisbane Summit, 15-16 November 2014, p. 2.

[370] The Hon Joe Hockey, 'The path to Brisbane – Setting up the G20 to make a difference', Speech in Washington DC, 8 October 2014.

[371] Katie Walsh, 'Court cases loom over tax schemes', *The Australian Financial Review,* 27 November 2014, p. 11.

[372] Catriona Lavermicocca, 'Role of reputation risk in tax decision making by large companies', paper presented at the 11th International Conference on Tax Administration, Australian School of Business, 2014, p. 7.

[373] Catriona Lavermicocca, 'Role of reputation risk in tax decision making by large companies', paper presented at the 11th International Conference on Tax Administration, Australian School of Business, 2014, p. 15.

[374] Scott D. Dyreng, Jeffrey L. Hoopes and Jaron H. Wilde, 'Public Pressure and Corporate Tax Behaviour', Oxford University Centre for Business Taxation, September 2014, p. 2.

that were not affected by the scrutiny (compliant firms). Specifically, their estimates suggest a 3.7 percentage point increase in the ETRs of non-compliant firms relative to the ETRs of compliant firms in the years following the initial public pressure to comply with disclosure of all subsidiaries.[375] The 34 firms subject to the scrutiny treatment in 2010 had median pre-tax book income of £618 million. Using a simple calculation, a 3.7 percent increase in ETR indicates increased tax expense of roughly £23 million per firm.[376]

In addition, the Centre of Business Taxation found the decrease in tax avoidance for non-compliant firms in the post-scrutiny period is most pronounced in the subsample of firms that experience a decrease in the percentage of total subsidiaries located in small tax haven countries – countries where subsidiaries are unlikely to have operational substance. In their view, these results suggest that non-compliant firms responded to negative public scrutiny by decreasing subsidiary use in locations where they would incur high disclosure costs (for example, political and reputational costs arising from increased scrutiny from tax authorities, customer and political outcry, or market penalties) and where it would be relatively easy to close subsidiaries without generation significant operating costs.[377] For the point of view of the Synod, this is a highly desirable outcome.

The Oxford University Centre for Business Taxation found that the evidence suggested that firms behave as though public scrutiny of tax avoidance activities is costly. They posited that reputational concerns of tax avoidance are likely to be concentrated in a specific kind of firm that is sensitivity to public scrutiny of disclosure that reveals tax-related information.[378]

Taylor and Richardson (2014) used a sample of 200 publicly listed Australian firms over the 2006-2010 period, to examine the associations between corporate tax avoidance and the reported significant uncertainty of a firm's tax position, the tax expertise and tax affiliations of its directors, and the performance-based remuneration incentives of its key management personnel using regression analysis.[379] They found the reported uncertainty of a firm's tax position, the tax expertise of its directors, and the performance-based remuneration incentives of its key management personnel are significantly positively associated with tax avoidance. Conversely, firms with board members who have at least one tax-related affiliation are significantly negatively associated with tax avoidance.[380] They concluded that the reporting of uncertain tax positions could assist tax authorities in gauging the nature of aggressive tax arrangements from publicly available information (for example, the annual report), and has important implications for financial reporting.[381]

Second Commissioner of Taxation, Andrew Mills, was quoted in the press in September 2014 as saying that the tax disclosure laws, required by Schedule 5 of the *Tax Laws*

[375] Scott D. Dyreng, Jeffrey L. Hoopes and Jaron H. Wilde, 'Public Pressure and Corporate Tax Behaviour', Oxford University Centre for Business Taxation, September 2014, p. 4.
[376] Scott D. Dyreng, Jeffrey L. Hoopes and Jaron H. Wilde, 'Public Pressure and Corporate Tax Behaviour', Oxford University Centre for Business Taxation, September 2014, p. 21.
[377] Scott D. Dyreng, Jeffrey L. Hoopes and Jaron H. Wilde, 'Public Pressure and Corporate Tax Behaviour', Oxford University Centre for Business Taxation, September 2014, pp. 4-5.
[378] Scott D. Dyreng, Jeffrey L. Hoopes and Jaron H. Wilde, 'Public Pressure and Corporate Tax Behaviour', Oxford University Centre for Business Taxation, September 2014, p. 6.
[379] Grantley Taylor and Grant Richardson, 'Incentives for corporate tax planning and reporting: Empirical evidence from Australia', *Journal of Contemporary Accounting and Economics*, **10** (2014), p. 1.
[380] Grantley Taylor and Grant Richardson, 'Incentives for corporate tax planning and reporting: Empirical evidence from Australia', *Journal of Contemporary Accounting and Economics*, **10** (2014), p. 1.
[381] Grantley Taylor and Grant Richardson, 'Incentives for corporate tax planning and reporting: Empirical evidence from Australia', *Journal of Contemporary Accounting and Economics*, **10** (2014), pp. 13-15.

Amendment (2013 Measures No. 2) Act 2013, would probably encourage companies to be more open about their tax affairs to protect their reputations.[382] "We're encouraging companies to get on the front foot and make the disclosures and clarifications themselves," he said.[383]

The ATO has assessed that 2,168 entities identified as reporting more than $100 million in total annual income and thus requiring disclosure of their tax information under the new Tax Laws Amendment Act ('the Corporate Transparency Population' or 'CTP') account for a significant and growing share of the Australian economy. Their share of total corporate tax paid grew from 54% in 2006 to 74% in 2012.[384] Approximately 60 per cent of the CTP report transactions with international related parties, worth more $253 billion in 2012.[385]

It is of significant concern that the Federal Government has announced that it plans to attempt to exempt privately owned companies from the tax transparency measures contained in the *Tax Laws Amendment (2013 Measures No. 2) Act* in part due to outrageous claims by these companies that it will increase the kidnapping risk of their owners. However, a document obtained from the Australian Taxation Office (ATO) under freedom of information has revealed that the private companies linked to Australian high wealth individuals have average profit margins lower than the other categories of companies (foreign owned and Australian publicly listed) in the group that the legislation applies to.[386] Almost half of these companies are foreign-headquartered and two-thirds have some form of international related party dealings.[387] They account for most of all international related party dealings reporte to the ATO, despite being only 21% of the businesses caught under the tax transparency measures of the *Tax Laws Amendment (2013 Measures No. 2) Act.*[388] It is possible that the lower average profit is simply due to this category of companies performing worse on average than other categories of businesses. However, there is the possibility that the lower average reported profitability is due to aggressive tax practices. Thus, the Synod believes that privately owned businesses should not be exempted from the tax transparency measures in the *Tax Laws Amendment (2013 Measures No. 2) Act.*

There is strong evidence that corporations cannot be relied upon to voluntarily disclose information relevant to community confidence that they are not engaged in tax dodging activities. Jeffrey Gramlich of the Hoops Institute at Washington State University and Janie Whiteaker-Poe of Baylor University crunched data at *The Economist*'s request and found a sharp increase since 2010 in the number of American firms dramatically reducing the number of tax-haven subsidiaries they disclosed. In one extreme case Google reported more than 100 divisions in 2009, but just two (both in Ireland) in 2012.[389] Mr Gramlich argued that there is a mass redefinition of subsidiaries as not "significant". Only material holdings have to be disclosed in US and Australia (whereas in, say, Germany all have to be reported). *The Economist* speculated that firms would never admit it, but the likely reason for this redefinition is increased scrutiny of their tax affairs.[390] *The Economist* argued that MNEs "move into the dark coincided with a surge in investigative articles about profit-shifting by multinationals."[391] *The Economist* took the view that not all the redefining is likely to be legal,

[382] Nassim Khadem, 'ATO: business needs to 'fess up on tax paid'', *The Australian Financial Review,* 10 September 2014.
[383] Nassim Khadem, 'ATO: business needs to 'fess up on tax paid'', *The Australian Financial Review,* 10 September 2014.
[384] Australian Taxation Office, 'Corporate Transparency Overview', September 2013, p. 1.
[385] Australian Taxation Office, 'Corporate Transparency Overview', September 2013, p. 1.
[386] Australian Taxation Office, 'Corporate Transparency overview', September 2013, p. 12.
[387] Australian Taxation Office, 'Corporate Transparency overview', September 2013, p. 12.
[388] Australian Taxation Office, 'Corporate Transparency overview', September 2013, p. 12.
[389] 'Corporate transparency: The openness revolution', *The Economist*, 13 December 2014.
[390] 'Corporate transparency: The openness revolution', *The Economist*, 13 December 2014.
[391] 'Corporate transparency: The openness revolution', *The Economist*, 13 December 2014.

but the companies are willing to take the risk: the most they can be fined in the US for de-disclosing significant subsidiaries is US$100 a day.[392] Transparency will ultimately need to be driven by government obligations in MNEs.

The Synod of Victoria and Tasmania is concerned about the level of confidentiality provided to multinational corporations under the *Taxation Administration Act 1953*, protecting such corporations from public scrutiny in regards to assessing the tax contribution these companies make and if there is a risk they are engaged in profit shifting activities. The Synod of Victoria and Tasmania believes greater transparency around the tax affairs of MNEs is necessary to ensure the public are able to better understand the corporate tax system and engage in tax policy debates, as well as to discourage aggressive tax minimisation practices by large corporate entities.

The Synod is also deeply concerned about the ability of Australian subsidiaries of foreign multinational companies to be able to avoid corporate rules that require them to disclose their earnings. For example, it was reported in the press in August 2014 that the directors of Twitter Australia Holdings had applied for an exemption from certain parts of the Corporations Act in 2013, according to documents registered with the ASIC. This meant that it did not prepare a financial or directors' report for the last calendar year. The exemption application, signed by sole Australian-based director John Pegg, argues the company does not need to file a financial report in Australia under a waiver available to foreign-owned companies that are "not part of a large group", as defined as having more than 50 employees and revenue of more than $25 million a year. Twitter has refused to disclose its Australian revenue, staff numbers or user numbers since starting to hire staff early last year. Twitter Australia Holdings' parent company is the Ireland-based Twitter International Company.[393]

Facebook has never disclosed its Australian earnings, having applied for the same exemption in 2009.[394]

Airbnb was also reported to have applied for the same exemption. The head of the Australian division of Airbnb, Sam McDonagh would not tell *The Age* how much tax the company paid locally, although a spokeswoman confirmed to *The Age* it booked its Australian revenue through an Irish subsidiary as of April 2014.[395]

The Synod is also concerned about rules introduced by the Keating government in 1995 that exempted some large companies from filing annual reports with the corporate regulator. For example, *The Australian* reported that privately owned food giant Bartter, which owns the famous Steggles brand and generates almost $1.5 billion a year in revenue, paid no tax in 2014 year despite declaring a profit and paying a dividend of almost $30 million to its owners, the Baiada and Camilleri families. Three Baiada companies are among almost 1500, including the Pratt family's Visy empire, Lindsay Fox's Linfox, and Kerry Stokes' Australian Capital Equity, that are "grandfathered" an exemption from disclosure laws.[396]

However, an insight into the business comes from Bartter Holdings, which has filed financial reports with ASIC since it was acquired by Baiada in 2009. Accounts for the year to 28 June 2014 showed that Bartter had revenue of $1.48 billion and declared a profit before tax of $9.74 million. During the year, it also paid dividends of $29.4 million to its shareholders,

[392] 'Corporate transparency: The openness revolution', *The Economist*, 13 December 2014.
[393] Madeleine Hefferman, 'Twitter another closed book on earnings', *The Canberra Times*, 25 August 2014.
[394] Madeleine Hefferman, 'Twitter another closed book on earnings', *The Canberra Times*, 25 August 2014.
[395] Georgia Wilkins, 'Airbnb takes Irish route to minimise tax', *The Age*, 10 September 2014.
[396] Ben Butler, 'Bartter escapes tax net on $1.5bn', *The Australian*, 16 December 2014.

companies ultimately owned by members of the Baiada and Camilleri families. However, income tax payable by the company is recorded in the accounts as zero. This is because pre-tax income is balanced out by deductions, mostly due to benefits claimed for the difference in the way stock and lease values are worked out for tax purposes. In the previous year, Bartter declared a profit before tax of $38.9 million on $1.35 billion in revenue, and paid $9.36 million in tax.

The 1995 exemption for the companies such as Bartter to file annual reports with the regulator should be rescinded as soon as possible.

In the US, Financial Instrument No. 48 requires firms to report the likelihood of being able to sustain their current tax positions through a tax audit. This disclosure has given US investors, analysts and tax researchers a powerful tool to examine both the aggressiveness and magnitude of tax positions that have been adopted by companies. The disclosure has been used to derive new anti-tax avoidance measures, including a model that can quantify the risk of a company's tax position being denied. A similar disclosure should be required in Australia, as corporations taking aggressive tax positions can have a detrimental effect on shareholder value and on other stakeholders.

On 18 March 2015 the European Commission announced a proposal to introduce the automatic exchange of information between EU members on their tax rulings.[397] This is a further tax transparency measure that Australia should support as becoming a global norm. The European Commission stated that the measures announced were necessary to "rebuild the link between where companies really make their profits and where they are taxed."[398] The Commission pointed out that currently different jurisdictions share very little information with one another about their tax rulings, which may facilitate cross-border tax avoidance. Within the EU it is currently at the discretion of Member States to decide whether a tax ruling might be relevant to another EU member. As a result, jurisdictions are often unaware of cross-border tax rulings issued elsewhere which may impact on their own tax bases. The Commission noted "The lack of transparency on tax rulings is being exploited by certain companies in order to artificially reduce their tax contribution."[399]

The European Commission has proposed that every three months, national tax authorities will have to send a short report to all other EU Member States on all cross-border tax rulings that they have issued. EU Member States will then be able to ask for more detailed information on a particular ruling.[400]

The Commission has taken the view that "The automatic exchange of information on tax rulings will enable Member States to detect certain abusive tax practices by companies and take the necessary action in response."[401]

The Commission announced it would also consider imposing new transparency requirements for MNEs to publicly disclose certain tax information. The Commission will work with Eurostat

[397] European Commission, 'Combatting corporate tax avoidance: Commission presents Tax Transparency Package', Media Release, 18 March 2015.
[398] European Commission, 'Combatting corporate tax avoidance: Commission presents Tax Transparency Package', Media Release, 18 March 2015.
[399] European Commission, 'Combatting corporate tax avoidance: Commission presents Tax Transparency Package', Media Release, 18 March 2015.
[400] European Commission, 'Combatting corporate tax avoidance: Commission presents Tax Transparency Package', Media Release, 18 March 2015.
[401] European Commission, 'Combatting corporate tax avoidance: Commission presents Tax Transparency Package', Media Release, 18 March 2015.

and EU Member States to try and determine a reliable estimate of the level of tax evasion and avoidance.[402]

The Synod of Victoria and Tasmania believes that greater transparency of the activities of multinational corporations is what they should be required to provide in return for the licence they are granted to operate in each jurisdiction in which they are present. This licence to operate ring fences their risk in the country in question, makes it easier to differentiate their tax liabilities between territories (allowing them to avoid double taxation) and grants them limited liability within that jurisdiction.[403] The ability to limit liability, not just within the corporation as a whole, but within each element of it that is wrapped within its own, self-contained, but nevertheless commonly controlled subsidiary, is an extraordinary situation that has developed seemingly by accident rather than design. The privilege of limited liability reduces the cost of capital because societies around the world explicitly accept the risk that if, for any reason, a constituent of a multinational corporation ceases to trade then the company and the owners of its capital will not have to make good the loss incurred and that risk will instead be transferred to the state in which it traded and the members of the community who traded with it in that place.[404] Greater transparency is a reasonable price in return for the privilege of limited liability, as it puts on record the risk that a community is exposing itself to by hosting the activities of a multinational corporation. This is almost impossible to determine with regard to the activities of a multinational corporation without country-by-country reporting. While the accounts of a nationally based corporation (if on the public record) by definition show the risk arising within the jurisdiction in which it is based, the accounts of a subsidiary of a multinational corporation working in a jurisdiction do not allow an assessment of risk to be made as they do not show the risks present to the corporation as a whole.[405] Companies that only trade in one country disclose the kind of data that country-by-country reporting would require of MNEs, because for a company operating in a single jurisdiction accounts are, by default, always on a country-by-country reporting basis (involving just one country). If can be argued that without country-by-country reporting for MNEs these single-jurisdiction companies are being put at an unfair disadvantage by existing accounting requirements.[406]

Most of the time the cost of the failures are contained within the business, banking and investment communities of each country as part of the collective risk they take. However, that is not always the case as the global financial crisis demonstrated. In many other parts of the world massive state bailouts were provided at the cost to the communities in those countries.

The current system of accounting for multinational companies recognises none of these risks.[407]

Country-by-country reporting by multinational corporations will allow the providers of capital to enjoy a better view of the risk they face, which should further reduce the cost of capital.[408]

402 European Commission, 'Combatting corporate tax avoidance: Commission presents Tax Transparency Package', Media Release, 18 March 2015.
403 Richard Murphy, 'Country-by-Country Reporting. Accounting for globalisation locally', Tax Justice Network, 2012, p. 2.
404 Richard Murphy, 'Country-by-Country Reporting. Accounting for globalisation locally', Tax Justice Network, 2012, pp. 2-3.
405 Richard Murphy, 'Country-by-Country Reporting. Accounting for globalisation locally', Tax Justice Network, 2012, p. 4.
406 Richard Murphy, 'Country-by-Country Reporting', *Tax Justice Focus* **9(1)** (2014).
407 Richard Murphy, 'Country-by-Country Reporting. Accounting for globalisation locally', Tax Justice Network, 2012, p. 3.
408 Richard Murphy, 'Country-by-Country Reporting. Accounting for globalisation locally', Tax Justice Network, 2012, p. 4.

Country-by-country reporting is intended to have both macroeconomic and microeconomic benefits.

Existing multinational corporation accounts eliminate intra-group trading and transactions from public view. Revealing this information is vital if trade relationships are to be understood and made fair.

There are clear benefits for investors with greater disclosure. Disclosure of the locations a multinational company is doing business in allows an investor to assess:[409]

- The degree of exposure to geopolitical risk that the company is likely to face, simply by its presence in certain locations;
- The degree of reputational risk that the company might face as a consequence of its decision to trade in certain locations;
- The trends in the geographical spread of the company's activities over time, indicating diversity, or absence thereof; and
- Whether they wish to invest in corporations with assets in locations they do not wish to associate with, which is likely to be of importance to some ethical investors.

The publication of a profit and loss account for each jurisdiction allows investors to assess:[410]

- The risk that the internal supply chains create for the company, most especially for governance. The use of secrecy jurisdictions has frequently been association with governance failures leading in turn to corporate failure, as occurred with Enron and Parmalat as examples;
- The flow of finance charges within the group, and the particular impact these might have on an intragroup basis with regard to the reallocation of profits between jurisdictions, giving rise to risk of transfer pricing or thin capitalisation challenge from taxation authorities, prejudicing the potential quality of future earnings; and
- The rate of return on capital employed by jurisdiction, suggesting whether or not assets are efficiently allocated by group management to the locations in which the company trades.

Investor groups themselves have started calling for greater transparency around the tax paying practices of MNEs. A group of investors, the UK Local Authority Pension Fund Forum (LAPFF), Quebec fund Batirente, Royal London Asset Management (RLAM), Paris based OFI Asset Management and Triodos Investment Management from the Netherlands issued a statement supporting the initial stage of the OECD BEPS Action plan and urging a general improvement in corporate governance, transparency and disclosure standards around taxation issues.[411]

LAPFF Chair, Councillor Kieran Quinn, said:[412]

> *Modernising the international taxation framework cannot be separated from global financial integrity, rebuilding trust and strengthening resilience in international financial structures and investment markets.*
>
> *As international investors, ensuring sound governance practices are embedded in corporate activities, including taxation planning and associated reporting and*

[409] Richard Murphy, 'Country-by-Country Reporting. Accounting for globalisation locally', Tax Justice Network, 2012, p. 32.
[410] Richard Murphy, 'Country-by-Country Reporting. Accounting for globalisation locally', Tax Justice Network, 2012, pp. 33-34.
[411] Tax Justice Network, 'Global investor groups support tax justice and transparency', 14 November 2014.
[412] Tax Justice Network, 'Global investor groups support tax justice and transparency', 14 November 2014.

disclosure mechanisms is a fundamental concern. Financial secrecy, opaque accounts and aggressive tax practices do not best meet our underlying objectives as inter-generational investors aiming for sustainable value creation.

We urge G20 Leaders to ensure transparency and disclosure, are directly embedded as core principles in relevant tax treaties and national agreements and to work towards a comprehensive multilateral agreement at G20 2015.

In addition, we call on transnational corporations to recognise that many existing financial practices around secrecy and taxation are not sustainable and no longer meet institutional investor governance expectations nor reflect growing civil society views of responsible, transparent corporate behaviour within a licence to operate.

Business efficiency is dependent upon the availability of high quality information. Unless that information is available then sub-optimal decisions on everything from resource allocation within a company to capital allocation between companies will be inefficient at the cost to society as a whole. Country-by-country reporting may take away some of the advantages that the current opacity provides to certain multinational companies, but it is beneficial to business as a whole.[413]

Companies already have the information required for country-by-country reporting, as they need to be able to assess their tax liabilities in every country in which they operate. To not have this information would already mean that officers of the companies in question were committing offences under laws obligating the preparation, maintenance and retention of accounting records.[414]

The OECD BEPS Action Plan has included work on country-by-country reporting, with a Master and Local Files for transfer pricing documentation. However, the failure so far to agree on acceptable procedures for access seems to have led some tax administrations to insist on inclusion of some information on internal transfers in the country-by-country reports, which we believe confuses the purposes of the two types of report. We share the view of the BEPS Monitoring Group that the Master File of transfer pricing documentation should be available automatically to any tax authority which considers that it has jurisdiction over the MNE.[415]

It was reported that a report carried out for the European Commission by PwC came to the findings that:[416]

Publishing turnover, staff numbers, taxes paid and subsidies received in every country banks operate in, could boost competitiveness, increase lending and bolster financial stability, the independent study by auditors PwC will find. It will fight tax evasion and not harm investment or result in excessive compliance costs for banks.

Further:[417]

PwC analysis will say the increased rigour of reporting would give a better picture of the true economic situation of a bank. This would make it easier for regulators to oversee it, resulting in more financial stability. PwC analysis also suggests increasing

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[413] Richard Murphy, 'Country-by-Country Reporting. Accounting for globalisation locally', Tax Justice Network, 2012, p. 56.

[414] Richard Murphy, 'Country-by-Country Reporting. Accounting for globalisation locally', Tax Justice Network, 2012, p. 57.

[415] BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, p. 2.

[416] Tax Justice Network, 'PWC report endorses country by country reporting for banks', http://www.taxjustice.net, 7 October 2014.

[417] Tax Justice Network, 'PWC report endorses country by country reporting for banks', http://www.taxjustice.net, 7 October 2014.

transparency will reduce the manipulation of earnings in order to pay less tax…. Reducing manipulation could have a positive impact on firms' competitiveness, according to the preliminary findings.

Calculations by economists found the reporting was unlikely to hurt banks' ability to access capital markets, where long-term finance can be raised.

The Synod of Victoria and Tasmania welcomes the announcement by the Treasurer in the 2015-16 budget that it will implement the OECD's new transfer pricing documentation standards from 1 January 2016 for MNEs operating in Australia with global revenue of $1 billion or more will be required to provide the ATO with:
- a Country-by-Country Report showing information on the global activities of the multinational, including the location of its income and taxes paid;
- a master file containing an overview of the multinational's global business, its organisational structure and its transfer pricinig policies; and
- a local file that provides detailed information about the local taxpayer's intercompany transactions.

This is a great step forward in MNE tax transparency, but the Synod believes that the high level report should be public for all the reasons outlined above. Such a report will not contain commercially sensitive information and will have benefits of being public in driving more efficient investment decisions, improve the functioning of markets and give the community greater confidence that MNEs are paying their taxes in the places they are actually doing business and creating value.

34.4.2.1 Progress on Multinational Corporation Tax Transparency Globally

The Synod of Victoria and Tasmania notes that Australia is now lagging behind both the US and the EU in measures of public transparency related to tax. The *US Dodd-Frank Wall Street Reform and Consumer Protection Act* requires companies in the oil, gas and mining sector listed on the US Securities and Exchange Commission to publicly report on taxes and royalties paid to governments on a country-by-country and project-by-project basis. On 9 April, the EU finalised negotiations to amend its Accounting and Transparency Directives, which will require EU-listed and large unlisted extractive industry and forestry companies to publicly publish the payments they make to governments on a country-by country and project-by-project basis.[418] The EU Directive will require disclosure of:

(a) Production entitlements;
(b) Taxes on production
(c) Royalties;
(d) Dividends;
(e) Signature, discovery and production bonuses;
(f) Licence fees, rental fees, entry fees and other considerations for licences and/or concessions; and
(g) Payments for infrastructure improvements.

It applies to all payments to governments in the over categories over €100,000. The EU Directive is provided in full in the Appendix to this submission.

[418] Council of the European Union, 'New transparency rules for the extractive industry and simplification of accounting requirements for companies', 17 April 2013, http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/intm/136824.pdf and Council of the European Union, '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 (Accounting Directive) (First reading) - Approval of the final compromise text' 12 April 2013, http://register.consilium.europa.eu/pdf/en/13/st08/st08328.en13.pdf

Norway's payment disclosure legislation for extractive industries came into force on 1 January 2014.

On 16 December 2014 the Canadian Parliament passed legislation that will require all oil, gas and mining companies to report their payments to governments overseas in terms of, inter alia, taxes, royalties, bonuses, regulatory charges and licence fees. The rules are expected to come into force by June 2015. Paladin Energy and OceanaGold, both dual-listed in Australia and Canada, will have to comply with new Canadian laws.[419]

The measures introduced by the US, the EU, Norway and Canada are steps towards reducing tax evasion and other forms of corruption by making it harder for companies to shift their revenues to secrecy jurisdictions unseen. It also increases the ability of citizens of developing countries to hold their own governments to account for the tax revenue they receive from natural resources. The extractives sector in developing countries has often been associated with grand levels of corruption and lost revenue for the ordinary people of the country.[420]

On 21 June 2012, the Norwegian Government announced it would introduce country-by-country reporting by the start of 2014.

Some corporations such as Talisman Energy, Statoil, Newmont Mining, Rio Tinto, Oil Search Limited, Resolute Mining, Paladin Energy, PanAust Limited, Newcrest Mining Limited and Anglogold Ashanti already disclose payments on a country-by-country basis.[421]

The EU has also moved towards a standard of country-by-country reporting for financial institutions[422], having negotiated rules stating:

1. *From 1st January 2015 Member States shall require institutions to disclose in their annual report, specifying by Member State and by third country in which it has operations, the following information on a consolidated basis for the financial year:*
    - *(a) Profit or loss before tax;*
    - *(b) Tax on profit or loss;*
    - *(c) Turnover;*
    - *(d) Number of employees;*
    - *(e) Public subsidies received.*

[2. The information referred to in paragraph 1, c) and d) shall be made public six months after entry into force of this directive as part of their annual report.]

3. The information referred to in paragraph 1, a), b) and e), shall be submitted by all European G-SIIs and S-IIs institutions six months after entry into force of this Directive to the Commission. The Commission, in consultation with the relevant ESAs, shall conduct a general assessment as regards potential significant negative economic consequences of the public disclosure of this type of information, including impact on competitiveness, investment and credit availability and financial stability.

[419] Georgia Wilkins, 'Canada forces ASX firms to disclose tax', *The Age*, 26 December 2014.
[420] Reuters, 'Zambia to audit miners, believe up to $1 bln owed', http://af.reuters.com/articlePrint?articleId=AFL5E8D75SN20120207, 7 February 2012.
[421] Kathryn Martorana, 'Legislating Transparency in the Extractive Sector', Policy Innovations, 2011, CAER and Publish What You Pay Australia, 'Australia: An Unlevel Playing Field. Extractive industry transparency on the ASX200', May 2013, pp. 8 -11.
[422] 'MEPs cap bankers' bonuses and step up bank capital requirements', http://www.europarl.europa.eu/news/en/pressroom/content/20130225IPR06048/html/MEPs-cap-bankers'-bonuses-and-step-up-bank-capital-requirements

The Commission shall submit its report to the Council and the European Parliament at the latest by 31 December 2014.

In the event that the Commission report identifies significant negative effects, it is invited to make a proposal for a modification of the scope and/or modalities of the reporting obligations laid down in paragraph 1. In such a situation the Commission shall be empowered to adopt a delegated act to defer the disclosure obligation laid down in paragraph 1. The Commission shall review every year the necessity to extend this deferral.

4. The report referred to in the first paragraph shall be audited in accordance with Directive 2006/43/EC of 17 May 2006 on statutory audits of annual accounts and consolidated accounts.

5. To the extent the reporting obligation laid down in paragraph 1 is provided for in future EU legislation beyond those laid down in this article, the obligation of this article shall cease to apply.

The EU negotiated rules on country-by-country reporting for financial institutions have wider scope than the rules on the extractive sector as they cover wherever the financial institution has an establishment, covering countries where the financial institution has a legal presence. The rules for country-by-country reporting for the extractives sector cover payments made in countries where the company has 'activities', such as exploration, extraction and development.

The UN Manual on Transfer Pricing already recommends that tax authorities require MNEs to provide worldwide consolidated accounts to facilitate effective implementation of transfer pricing audits.[423]

34.4.3 Transfer Pricing

As noted earlier, transfer pricing by multinational corporations operating in Australia is one of the areas where the ATO has noted "some businesses take aggressive positions in contestable areas of the law".[424]

The Synod of Victoria and Tasmania remains concerned about the limitations of the 'arm's length' principle (ALP), especially transactional methods, and urges supporting other methods at a multilateral level to combat tax evasion through transfer mispricing. The OECD arm's length principle particularly has disadvantaged developing countries in combating tax evasion by multinational companies, as such countries often lack the resources to be able to investigate and prosecute multinational companies engaged in tax evasion through transfer mispricing based on the arm's length principle. The Tax Justice Network has stated 'In recent years many developing countries have introduced or strengthened arrangements for combating tax avoidance, including abusive transfer pricing. However, the vast majority of poor developing countries do not have the resources to apply the complex and time-consuming checks on transfer pricing demanded by the OECD approach. Even the largest among them, such as Brazil, China, India, and South Africa have experienced serious difficulties in applying the ALP, especially in finding suitable 'comparables.'[425] Brazil, China,

[423] 'No more shifty business', Civil Society response to the OECD's Base Erosion and Profit Shifting report on tax.
[424] Australian Taxation Office (2014), *ATO Annual Report 2013-14*, p. 59.
[425] Sol Picciotto, 'Towards Unitary Taxation of Transnational Corporations' Tax Justice Network, 14, http://www.taxjustice.net/cms/upload/pdf/Towards_Unitary_Taxation_1-1.pdf Last viewed 11 December 2012.

India and South Africa are examples of countries which adopt approaches that diverge from those acceptable to OECD countries.

The Synod of Victoria and Tasmania is concerned that the current OECD guidelines are inadequate to address the problem of 'double non-taxation', where a multinational company is able to ensure a portion of its profits are untaxed by any jurisdiction.

The Synod of Victoria and Tasmania believes that international corporate tax abuse means that many of the underpinning international principles are fundamentally flawed, with the most dominant example being the "separate entity" approach and the arm's length requirement under current transfer pricing rules. This is particularly evident in certain industries such as internet-based business and financial firms. Even the OECD itself recognises the problems of the current transfer pricing system. For example, the head of the OECD's Transfer Pricing Unit, Joseph Andrus, was quoted in the press as saying:

> *Whatever it is we are doing isn't producing accurate results if it turns out that 75% of the world's income, under a transfer pricing system, is reflected as being earned in Singapore, Switzerland, the Cayman Islands and Bermuda.*[426]

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 intra-company transactions does not make sense.[427] Simply, there is an air of artificiality in applying the arm's length standard to multinational companies.[428] As multinational companies gain a greater efficiency in transactions over unrelated firms[429], their costs will be lower and profits higher than transactions between unrelated firms. This means the arm's length principle overestimates the costs of transactions for multinationals and, hence, underestimates their profits meaning a portion of the profit goes untaxed.

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 based on the arm's length principle. The US General Accounting Office did a study in the early 1990s that

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[426] Julie Martin, "OECD Moving Quickly With Base Erosion Project", 14 February 2013.

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

[428] Kerrie Sadiq, 'The Traditional Rationale of the Arm's Length Approach to Transfer Pricing – Should the Separate Accounting Model be maintained for modern Multinational Entities?', J. Australian Taxation **7(2)**, (2004), p. 198; and Michael Durst, 'It's Not Just Academic: The OECD Should Reevaluate Transfer Pricing Laws', Tax Analysts, 18 January 2010.

[429] Kerrie Sadiq, 'The Traditional Rationale of the Arm's Length Approach to Transfer Pricing – Should the Separate Accounting Model be maintained for modern Multinational Entities?', J. Australian Taxation **7(2)**, (2004), pp. 237, 241; Michael Durst, 'It's Not Just Academic: The OECD Should Reevaluate Transfer Pricing Laws', Tax Analysts, 18 January 2010; and Michael Durst, 'The Two Worlds of Transfer Pricing Policymaking', Tax Justice Network, 24 January 2011.

indicated in over 90% of the cases the three traditional methods of Comparable Uncontrolled Price could not be applied because comparables could not be found.[430]

Michael Durst, a former director of the IRS advance pricing agreement, has stated that in 20 years of practice: "I have seldom, if ever, seen a real-life transfer pricing controversy resolved by anything that could reasonably be viewed as sufficiently close comparables."[431]

Reuvan Avi-Yonah points out in the US, the fact that neither taxpayers nor enforcement authorities typically have clear standards for judging compliance with the arms' length principle means that issues involving very large amounts – billions of dollars – of federal revenue are resolved in examination, settled in Appeals, resolved in negotiations under tax treaties with foreign governments, negotiated through advance pricing agreements, or settled by lawyers out-of-court after examination. In most cases, federal privacy law require that this decision-making occur outside of the public eye. The resolution of issues involving such large amounts of money, without the benefit of clearly discernible decision-making standards and public scrutiny, is not healthy for the tax system.[432]

Michael Durst has also argued:[433]

> *A second fundamental flaw in the arm's-length system, which has become increasingly evident over the past decade, is that by treating different affiliates within the same group as if they were free-standing entities, the system respects the results of written contracts between those related entities. These contracts have no real economic effects, as the same shareholders stand on both sides of them, but they nevertheless are given effect under the arm's-length standard.*
>
> *Thus, multinational groups generally have been free to enter into internal contracts that shift interests in valuable intangibles to tax haven countries in which taxpayers conduct little if any real business activity.*

Associate Professor Antony Ting from the University of Sydney Business School has stated of the tax avoidance techniques used by MNEs:[434]

> *Most of these techniques take advantage of the mismatch between the separate entity principle embedded in the tax law and the economic reality that a multinational operates as one single enterprise.*
>
> *The attachment to the separate entity principle by the tax law dictates that the ATO has no choice but to respect the intra-group transactions. The ATO may attempt to challenge the transactions to see if they are done on an arm's length basis. Sadly, such an attempt is likely to be in vain, as the "successful" tax avoidance stories of Apple and Google have proved that the current transfer pricing rules are ineffective in tackling the modern international tax avoidance structures.*
>
> *The anti-avoidance war tax authorities are fighting for is unfair, as multinationals have much flexibility to establish wholly-owned subsidiaries in low-tax countries and to*

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

[431] Michael Durst, 'The Two Worlds of Transfer Pricing Policymaking', Tax Justice Network, 24 January 2011.

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

[433] Michael Durst, 'It's Not Just Academic: The OECD Should Reevaluate Transfer Pricing Laws', Tax Analysts, 18 January 2010.

[434] Antony Ting, 'Hockey to tighten tax laws for multinationals but loopholes still exist', *The Conversation,* 4 July 2014.

create intra-group transactions that have no real economic impact to the group as a whole. It is a war that tax authorities are unlikely to win until the tax law is free from the handcuffs of the separate entity principle and can look at a multinational as a single enterprise.

The Synod of Victoria and Tasmania is of the view that an alternative system of unitary taxation would bring the international system into closer alignment with economic reality, and hence greatly improve its effectiveness and legitimacy.[435] There is particular concern that the arm's length principle applies poorly to more modern types of businesses and that unitary taxation is a viable alternative to industries such as internet based businesses and multinational financial institutions.[436]

34.4.3.1 An Alternative System

The Synod of Victoria and Tasmania believes 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.[437] 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.

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 Synod of Victoria and Tasmania 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. By using worldwide rather than origin-based income, formulary apportionment eliminates any need for geographic income and expenses accounting. In doing so, it largely eliminates the possibility of transfer price manipulation and

[435] Sol Picciotto, 'Towards Unitary Taxation of Transnational Corporations' Tax Justice Network, 10, http://www.taxjustice.net/cms/upload/pdf/Towards_Unitary_Taxation_1-1.pdf Last viewed 11 December 2012.

[436] Sol Picciotto, 'Towards Unitary Taxation of Transnational Corporations' Tax Justice Network, 16, http://www.taxjustice.net/cms/upload/pdf/Towards_Unitary_Taxation_1-1.pdf Last viewed 11 December 2012.

[437] 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 and Sol Picciotto, 'Towards Unitary Taxation of Transnational Corporations' Tax Justice Network, http://www.taxjustice.net/cms/upload/pdf/Towards_Unitary_Taxation_1-1.pdf Last viewed 11 December 2012.

several other tax avoidance techniques created by tax rate variation between geographic jurisdictions.[438]

The solution of unitary taxation 'fits the economic reality that TNCs are usually oligopolies based on distinctive or unique technology or know-how: they exist because of the advantages and synergies that come from combining economic activities on a large scale and in different locations. These advantages cannot be attributed to a single location, but to the whole global entity. Treating each affiliate as a separate entity for tax purposes is impractical and does not correspond to economic reality.'[439]

The Tax Justice Network views unitary taxation as a superior model:

> '*Unitary taxation would greatly reduce opportunities for international tax avoidance due to profit-shifting and the use of tax havens. By simplifying tax administration, it would cut the costs of compliance for firms and would benefit poor developing countries especially. TNCs also provide powerful political cover for many tax havens: by curbing their use unitary taxation would make it politically far easier to tackle tax havens on financial secrecy and many other issues. And by aligning tax rules more closely to economic reality it would improve the fairness and transparency of international tax and help create a level playing field for business.*'[440]

The Synod of Victoria and Tasmania believes that unitary taxation is a superior model for taxing multinational entities. Despite some obvious transitional problems, the Tax Justice Network also believes that the time is now right for reform.[441] Hybrid versions of the arm's length and unitary taxation system are possible as interim steps.[442] The Synod of Victoria and Tasmania believes that managed transition through serious studies, the adoption of Unitary Taxation by groups of countries or the introduction of unitary taxation within the present system are all viable and attainable methods of bringing about a system which fits with economic reality and reduces the opportunity for tax avoidance through profit shifting.[443]

34.4.4. Automatic Exchange of Information between Tax Authorities

The Synod of Victoria and Tasmania supports the growing global trend towards requiring automatic exchange of tax related information between tax authorities as a measure to stem tax evasion through shifting income offshore. The OECD has endorsed automatic exchange of information (AEOI) as proving "to be a useful way to implement enhanced international tax

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[438] 'Reforming Corporate Taxation in a Global Economy: A Proposal to Adopt Formulary Apportionment', The Hamilton Project, The Brookings Institute, Washington USA, Policy Brief No. 2007-08, June 2007, p. 3.

[439] Sol Picciotto, 'Towards Unitary Taxation of Transnational Corporations' Tax Justice Network, 1, http://www.taxjustice.net/cms/upload/pdf/Towards_Unitary_Taxation_1-1.pdf Last viewed 11 December 2012.

[440] Sol Picciotto, 'Towards Unitary Taxation of Transnational Corporations' Tax Justice Network, 1, http://www.taxjustice.net/cms/upload/pdf/Towards_Unitary_Taxation_1-1.pdf Last viewed 11 December 2012.

[441] Sol Picciotto, 'Towards Unitary Taxation of Transnational Corporations' Tax Justice Network, 1, http://www.taxjustice.net/cms/upload/pdf/Towards_Unitary_Taxation_1-1.pdf Last viewed 11 December 2012.

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

[443] For a discussion on these options see Sol Picciotto, 'Towards Unitary Taxation of Transnational Corporations' Tax Justice Network, 14-16, http://www.taxjustice.net/cms/upload/pdf/Towards_Unitary_Taxation_1-1.pdf Last viewed 11 December 2012.

co-operation".[444] The OECD has outlined the benefits of automatic information exchange as:[445]

> *"It can provide timely information on non-compliance where tax has been evaded either on an investment return or the underlying capital sum. It can help detect cases of non-compliance even where tax administrations have no previous indications of non-compliance. Other benefits include its deterrent effects, increasing voluntary compliance and encouraging taxpayers to report all relevant information. Automatic exchange may also help educate taxpayers in their reporting obligations, increase tax revenues and thus lead to fairness – ensuring that all taxpayers pay their fair share of tax in the right place at the right time."*

Further, "automatic exchange as a tool to counter offshore non-compliance has a number of benefits. It can provide timely information on non-compliance where tax has been evaded either on an investment return or the underlying capital sum."

The Synod notes that the main benefits from AEOI are in dealing with tax evasion and tax avoidance by individuals rather than MNEs.[446]

The Synod welcomes the commitment of the Australian Government to implement the Common Reporting Standard (CRS) and participate in global automatic exchange of information. As stated by the Treasurer, The Hon Joe Hockey:[447]

> *We have also taken significant steps to enhance transparency and minimise the opportunities for tax cheats to evade their obligations. The G20 has agreed to begin the automatic exchange of tax information, using the Common Reporting Standard, from 2017 to 2018. This will mean individuals will no longer be able to hide their offshore income from tax authorities.*

The G20 committed to implementing multilateral AEOI through the Common Reporting Standard at the Leaders' Summit in Brisbane in November 2014:[448]

> *To prevent cross-border tax evasion, we endorse the global Common Reporting Standard for automatic exchange of tax information (AEOI) on a reciprocal basis. We will begin to exchange information automatically with each other and with other countries by 2017 or end-2018, subject to completing necessary legislative procedures. We welcome financial centres' commitments to do the same and call on all to join us.*

The ATO has stated:[449]

> *The CRS will significantly increase the availability and quality of offshore data to improve our business focus and efficiency in risk assessment, case selection and enforcement.*
>
> *Australia intends to implement the CRS in a staged process from 1 January 2017, subject to further consultation with financial institutions and a final Government*

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[444] OECD, "Tackling Offshore Tax Evasion. The G20/ OECD Continues to make progress", June 2012, p. 2.
[445] OECD, "Tackling Offshore Tax Evasion. The G20/ OECD Continues to make progress", June 2012, p. 4.
[446] Richard Eccleston, 'The Dynamics of Global Economic Governance: The OECD, the Financial Crisis and the politics of international tax cooperation', Edward Elgar Cheltenham, 2012.
[447] The Hon Joe Hockey, 'Employment in the G20 Agenda – 'Ambitions for the Brisbane Summit' – L20 Summit', Media Release, 14 November 2014.
[448] G20 Leaders' Communique, Brisbane Summit, 15-16 November 2014, p. 2.
[449] Mark Konza, 'Base erosion and profit shifting – a progress report on G20/OECD action', Melbourne, ATO Media Centre, 25 September 2014, https://www.ato.gov.au/Media-centre/Speeches/Other/BEPS---a-progress-report-on-G20/OECD-action/

decision on implementation. A key consideration of this approach was to minimise the compliance costs on financial institutions.

The OECD reports the EU experience with the Savings Directive suggests that in the absence of automatic information exchange in excess of 75% of taxpayers may not have complied with their residence country tax obligations.[450] Further examples were provided by the OECD with regards to foreign source income:[451]

- In 2009, Norway received automatic information exchange from a number of its treaty partners. Files above a certain threshold were verified against the returns of income filed by taxpayers in Norway. Results of the investigation disclosed that in 38.7% of the cases income which was taxable in Norway had not been reported.
- Under a special project, Denmark used information received automatically to conduct 1,000 audits, resulting in additional tax revenue. In addition, 1,100 letters were sent out to other taxpayers with the information that the Danish Tax Administration received on foreign income. This resulted in 440 persons reporting foreign income in their tax return which they had not reported in previous years.

Currently Denmark engages in AEOI with around 70 jurisdictions. In 2012, Demark received information on more than 116,000 individual and entity taxpayers, involving a value of more than €4.7 billion (most of which related to interest) covering interest, dividends, royalties, salaries, pensions, capital gains, business profits, income from independent personal services, income from immovable property, director fees and income to artists, sportsmen and students. In the same year, Denmark sent information on more than 660,000 individuals and entity taxpayers to other jurisdictions, involving a value of more than €60 billion (most of which referred to interest) covering interest, dividends, salaries, pensions and sales proceeds.[452]

In the case of Argentina, exchange of information (including both AEOI and on-request sharing) resulted in more than 1,700 tax returns being voluntarily rectified, increasing the taxable base by US$640 million in 2013.[453]

In the case of Belgium, AEOI through the European Savings Tax Directive resulted in analysis of 6,510 cases in 2006 which increased the tax base by €75 million.[454]

Germany engages in AEOI with 28 EU members and eight additional European jurisdictions or British related territories based in European Directives, covering interest payments for individuals. In 2011, through AEOI Germany received information on €3.3 billion of interest payments and sent records involving €1.2 billion to other jurisdictions.[455]

As an example of the limitations of information exchange on request, France released data on its tax information exchange requests in January 2013. The data showed that of 230

[450] OECD, “Tackling Offshore Tax Evasion. The G20/ OECD Continues to make progress”, June 2012, p. 18.
[451] OECD, “Tackling Offshore Tax Evasion. The G20/ OECD Continues to make progress”, June 2012, p. 18.
[452] Andres Knobel and Markus Meinzer, ‘Automatic Exchange of Information: An Opportunity for Developing Countries to Tackle Tax Evasion and Corruption’, Tax Justice Network, June 2014, pp. 49-50.
[453] Andres Knobel and Markus Meinzer, ‘Automatic Exchange of Information: An Opportunity for Developing Countries to Tackle Tax Evasion and Corruption’, Tax Justice Network, June 2014, p. 24.
[454] Andres Knobel and Markus Meinzer, ‘Automatic Exchange of Information: An Opportunity for Developing Countries to Tackle Tax Evasion and Corruption’, Tax Justice Network, June 2014, p. 24.
[455] Andres Knobel and Markus Meinzer, ‘Automatic Exchange of Information: An Opportunity for Developing Countries to Tackle Tax Evasion and Corruption’, Tax Justice Network, June 2014, p. 50.

requests made in the first eight months of 2011, they received only 71 replies by the end of 2012.[456]

The Synod of Victoria and Tasmania notes that Australia already provides information on tax related matters to over 40 countries and receives information automatically from 20 countries. Australia sent more than one million records in a particular year.[457]

There are likely to be very significant benefits from the implementation of AEOI in terms of greater tax voluntary compliance (as AEOI acts as a deterrent against tax avoidance and tax evasion) and in assisting the ATO in its compliance activities. The ATO reported in its 2012-2013 annual report that even the existing exchange of information cases with treaty partners contributed to around $480 million of adjusted tax, penalties and interest.[458] This was the result of the exchange of information on over 1,300 occasions under double tax agreements and tax information exchange agreements[459], a 66% increase on the previous financial year.[460] With access to AEOI the level of revenue recovered is likely to substantially increase.

That greater exchange of information will benefit Australia is demonstrated by the number of cases involving Australians engaging in tax evasion and tax avoidance using offshore jurisdictions. Australia appears to have benefited from the leak of information about accounts, companies, trusts and funds held in the British Virgin Islands, Cayman Islands, Cook Islands and Singapore in April 2013. It was reported that the ATO was working with UK and US tax administrations on analysing a 400 GB data cache.[461] It was reported more than 500 Australians were identified in the information.[462] As a result two Australians were placed under criminal investigation. A further 65 were identified as high risk as they had each transferred more than $1 million in or out of Australia without declaring the funds in their tax returns.[463] An audit was also conducted into a Melbourne man who claimed more than $25 million in share deals were carried out for offshore clients. The ATO believed the man was the real owner of the shares.[464]

By implementing AEOI domestically, Australia will also be assisting in making AEOI a global norm. AEOI becoming a global norm will be of benefit to Australia assisting developing countries in their domestic resource mobilising efforts to become self-sufficient, providing the developing countries with relevant information, a substantial share of which they currently would be forced to seek via costly individual requests. A survey of developing country governments conducted by the Tax Justice Network found the most frequently sought types of information concern bank account ownership information and the account balance.[465]

Charles Kinsley, China tax principal at KPMG, was quoted in the media as saying “With the Common Reporting Standard, the ability of people to hide their money in banks is going to disappear. The ability to hide behind an overseas company will be a thing of the past. The number of companies in Hong Kong and Singapore using BVI and Cayman companies for

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[456] E-mail from by Emeritus Professor Sol Picciotto from Lancaster University, 2 February 2013.
[457] OECD, “Tackling Offshore Tax Evasion. The G20/ OECD Continues to make progress”, June 2012, pp.16-17.
[458] Australian Taxation Office, ‘Commissioner of Taxation Annual Report 2012-2013’, p. 19.
[459] Australian Taxation Office, ‘Commissioner of Taxation Annual Report 2012-2013’, pp. 21-22.
[460] Australian Taxation Office, ‘Commissioner of Taxation Annual Report 2012-2013’, p. 62.
[461] Kimberley Porteous, Michael Hudson and Sasha Chavkin, ‘Release of Offshore Records Draws Worldwide Response’, http://www.icij.org/blog/, 17 December 2013.
[462] Kate McClymont, Linton Besser and James Robertson, ‘Big names facing tax probe’, *The Age,* 15 June 2013, p. 1.
[463] Ben Butler, ‘Scores of rich Australians dodging taxes, ATO says’, *The Age*, 10 May 2013.
[464] Ben Butler, ‘Scores of rich Australians dodging taxes, ATO says’, *The Age*, 10 May 2013.
[465] Andres Knobel and Markus Meinzer, ‘Automatic Exchange of Information: An Opportunity for Developing Countries to Tackle Tax Evasion and Corruption’, Tax Justice Network, June 2014, p. 43.

non-disclosure will decrease". He also said that the number of high-net-worth individuals using private banks in Hong Kong and Singapore to avoid disclosure would shrink.[466] Toine Knipping, chief executive of international trust company Amicorp, said many Hong Kong shell companies would disappear. "There are over 100,000 companies registered in Hong Kong, and a significant portion of them will be affected as they are just a thin file in the cabinet."[467]

34.4.4.1 Measures to encourage Automatic Information Exchange

Given that some jurisdictions have made a deliberate choice to act as secrecy jurisdictions and facilitate tax dodging and profit shifting the MNEs, Australia should implement measures that seek to penalise such jurisdictions to encourage them to comply with automatic information exchange and other global standards addressing money laundering, tax avoidance and tax evasion. Such measures should include:

- Disallowing deductions or credits with respect to transactions with residents of a jurisdiction that does not effectively exchange information (which is already used by Argentina, Brazil, Germany, India and Italy);
- Applying higher rates of withholding taxes on all transfers of funds to jurisdictions that do not engage in effective information exchange (which is already used by Argentina, France, Mexico and the Slovak Republic);
- Deeming funds received from a secrecy jurisdiction that does not provide automatic information exchange to be assessable income; and
- The application of administrative measures which discourage companies from using non-co-operative jurisdictions, such as reversing the burden of proof, higher audit requirements and requiring records to be kept for 20 years rather than the standard five years for records involving the use of secrecy jurisdictions that do not commit to automatic information exchange).

34.4.5 Combating Artificial Debt Loading

The OECD has noted that the tax treatment of debt means that "leveraging high-tax group companies with intra-group debt is a very simple and straightforward way to achieve tax savings at group level."[468] It concludes the tax treatment of related party debt-financing is a key pressure area[469] and that thin capitalization rules are a relevant domestic anti-avoidance strategy.[470] The Mirrlees review of taxation also identified that financial innovation increased the ability of corporations to exploit differences in the tax treatment of debt and equity.[471]

As noted earlier, work by Taylor and Richardson found that for publicly listed Australian companies thin capitalisation and transfer mispricing were the primary methods of tax avoidance in the period 2006 to 2009.[472]

In combination, the three Ralph Review changes to Australia's international arrangements gifted tax planners and their clients a decade of unprecedented opportunity to misuse the new regime.

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[466] Toh Han Shih, 'Data exchange to combat tax evasion seen affecting Hong Kong private banks', http://www.scmp.com/, 7 July 2014.
[467] Toh Han Shih, 'Data exchange to combat tax evasion seen affecting Hong Kong private banks', http://www.scmp.com/, 7 July 2014.
[468] OECD, 'Addressing Base Erosion and Profit Shifting', OECD Publishing, http://dx.doi.org/10.1787/9789264192744-en, 2013, p. 43.
[469] OECD, 'Addressing Base Erosion and Profit Shifting', OECD Publishing, http://dx.doi.org/10.1787/9789264192744-en, 2013, p. 6.
[470] OECD, 'Addressing Base Erosion and Profit Shifting', OECD Publishing, http://dx.doi.org/10.1787/9789264192744-en, 2013, p. 38.
[471] Alan Auerbach, 'The Mirrlees Review: A US Perspective', *National Tax Journal*, June 2012, p. 15.
[472] Grantley Taylor and Grant Richardson, "International Corporate tax Avoidance Practices: Evidence from Australian Firms", The International Journal of Accounting **47**, (2012), p. 491.

As noted by the Business Tax Working Group Discussion Paper, Australia's thin capitalization rules allow for significant profit shifting opportunities, noting:[473]

> *The large information asymmetry that third parties face when auditing (or potentially auditing) tax calculations that can be based on subjective market and firm-specific information and assumptions raises integrity concerns.*

The Business Tax Working Group discussion paper noted Australia's thin capitalization rules have given "multinationals a tax advantage over their Australian market competitors"[474], as:

> *It should also be kept in mind that the gearing levels these rules allow are higher than the levels employed by those firms that have little capacity/incentive to shift profits out of Australia (that is, purely domestic firms or firms that rely on truly independent financing arrangements).*

The recent changes to the thin capitalization rules through the *Tax and Superannuation Laws Amendment (2014 Measures No 4) Act 2014* were expected to impact on 185 inward investing general entities with estimated total debt deductions of $3.7 billion and 145 outward investing general entities with estimated total debt deductions of $5.0 billion.[475]

The previous gearing ratio allowed in the safe harbor debt limits was much higher than the normal gearing levels of most corporates with truly independent arrangements. As noted on page 4 of the Exposure Draft of the Explanatory Memorandum "recent data suggests these limits are now higher than the normal gearing levels of most corporates with truly independent financing arrangements, which is often less than 1:1 on a debt-to-equity basis."

However, the Synod remains concerned the current debt-to-equity approach in Australian law is open to abuse by entities finding ways of having their Australian assets overvalued in order to load them up with debt and maximize the deductions allowed under the safe harbor limit. The reduction in the safe harbor limits in the *Tax and Superannuation Laws Amendment (2014 Measures No 4) Act 2014* is likely to provide further incentive to this form of abuse. The Synod recommends a thorough study to examine how widespread the overvaluing of assets is.

The Synod was concerned about the increase in the *de minimis* threshold for the application of the thin capitalisation limits from $250,000 to $2 million of debt deductions in the *Tax and Superannuation Laws Amendment (2014 Measures No 4) Act 2014*. This would appear to be large for small businesses and the Synod is concerned to the degree this may open up additional opportunities for abuse of debt loading and interest deductions. The Synod notes the ATO estimated the increase in the *de minimis* threshold resulted in almost half of the entities currently subjected to the thin capitalization rules being exempted (an exemption for 1,200 entities out of 2,500 previously subject to the rules).[476]

The Synod urges the Australian Government to support moves internationally to apply a formulaic apportionment of debt across a multinational company based on the substance of its operations rather than on artificial legal structures designed to avoid paying tax and to engage in debt-equity arbitrage. Such an approach, of treating the multinational as a unitary entity, has been advocated by the BEPS Monitoring Group, made up of specialists on

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[473] Business Tax Working Group, Discussion Paper, 13 August 2012, p. 25.
[474] Business Tax Working Group, Discussion Paper, 13 August 2012, p. 25.
[475] The Board of Taxation, 'Review of the Thin Capitalisation Arm's Length Debt Test', Discussion Paper, December 2013, p. 19.
[476] The Board of Taxation, 'Review of the Thin Capitalisation Arm's Length Debt Test', Discussion Paper, December 2013, p. 19.

various aspects to international tax.[477] As they point, the 'separate entity' principle when dealing with multinational companies:[478]

> *…creates perverse economic incentives which will continue to drive the creation of complex structures and use of elaborate transactions exploiting differences between national laws. The only effective way to end this pointless and wasteful game is to deal with the root of the problem, the strong motivation for BEPS created by the separate entity principle.*

This view has been shared by Associate Professor Antony Ting from the University of Sydney Business School, who wrote in July 2014:[479]

> *The fundamental problem of the thin capitalisation regime is that instead of recognising the reality that a multinational operates as one single enterprise, the tax law insists on treating each company as a separate taxpayer. This means it fails to consider that the group as a whole bears lower or even no interest expenses. It will continue to allow deduction of intra-group expenses that are created artificially for tax avoidance purposes.*

34.4.6 OECD BEPS Action Plan

The OECD has engaged a 'Base Erosion and Profit Shifting' (BEPS) Action Plan, which is to run over a two year period, 2014 to 2015. The OECD has been reporting progress to the G20 and the OECD countries themselves.

The BEPS Action Plan provides for 15 actions scheduled to be finalised in three phases: September 2014, September 2015 and December 2015. Deliverables are expected:[480]

September 2014

- An in-depth report identifying tax challenges raised by the digital economy and the necessary actions to address them (Action 1);
- Recommendations regarding the design of domestic and tax treaty measures to neutralise the effects of hybrid mismatch arrangements, both from a domestic and treaty law perspective (Action 2);
- Finalise the review of member country regimes in order to counter harmful tax practices more effectively (Action 5);
- Recommendations regarding the design of domestic and tax treaty measures to prevent abuse of tax treaties (Action 6);
- Changes to the transfer pricing rules in relation to intangibles (Action 8);
- Changes to the transfer pricing rules in relation to documentation requirements (Action 13); and
- A report on the development of a multilateral instrument to implement the measures developed in the course of the work on BEPS (Action 15).

September 2015

- Recommendations regarding the design of domestic rules to strengthen Controlled Foreign Companies (CFC) Rules (Action 3);
- Recommendations regarding the design of domestic rules to limit base erosion via interest deductions and other financial payments (Action 4);

[477] BEPS Monitoring Group, 'Neutralising the Effects of Hybrid Mismatch Arrangements', 2 May 2014, p. 3.
[478] BEPS Monitoring Group, 'Neutralising the Effects of Hybrid Mismatch Arrangements', 2 May 2014, p. 3.
[479] Antony Ting, 'Hockey to tighten tax laws for multinationals but loopholes still exist', *The Conversation* 4 July 2014.
[480] OECD, 'About BEPS', http://www.oecd.org/tax/beps-about.htm

- Strategy to expand participation to non-OECD members to counter harmful tax practices more effectively (Action 5);
- Tax treaty measures to prevent the artificial avoidance of permanent establishment status (Action 7);
- Changes to the transfer pricing rules in relation to risks and capital, and other high-risk transactions (Actions 9 and 10);
- Recommendations regarding data on BEPS to be collected and methodologies to analyse them (Action 11);
- Recommendations regarding the design of domestic rules to require taxpayers to disclose their aggressive tax planning arrangements (Action 12);
- Tax treaty measures to make dispute resolution mechanisms more effective (Action 14).

December 2015
- Changes to the transfer pricing rules to limit base erosion via interest deductions and other financial payments (Action 4);
- Revision of existing criteria to counter harmful tax practices more effectively (Action 5); and
- The development of a multilateral instrument (Action 15).

The technical work on BEPS is being undertaken by the OECD Committee on Fiscal Affairs (CFA) through its subsidiary bodies, namely:[481]
- **Working Party 1** *(Tax Conventions and Related Questions*), in relation to part of action 2 (Neutralise the Effects of Hybrid Mismatch Arrangements), action 6 (Prevent Treaty Abuse), action 7 (Prevent the Artificial Avoidance of PE Status), and action 14 (Make Dispute Resolution Mechanisms More Effective);
- **Working Party 2** *(Tax Policy Analysis and Tax Statistics)*, in relation to action 11 (Establish Methodologies to Collect and Analyse Data on BEPS);
- **Working Party 6** *(Taxation of Multinational Enterprises)*, in relation to part of action 4 (Limit Base Erosion via Interest Deductions and Other Financial Payments), actions 8 (Assure that Transfer Pricing Outcomes are in Line With Value Creation / Intangibles), 9 (Assure that Transfer Pricing Outcomes are in Line With Value Creation / Risks and Capital), 10 (Assure that Transfer Pricing Outcomes are in Line With Value Creation / Other High-Risk Transactions), and 13 (Re-examine Transfer Pricing Documentation);
- **Working Party 11** *(Aggressive Tax Planning)*, established by the CFA to carry out the work in relation to part of action 2 (Neutralise the Effects of Hybrid Mismatch Arrangements), action 3 (Strengthen CFC rules), part of action 4 (Limit Base Erosion via Interest Deductions and Other Financial Payments), and action 12 (Require Taxpayers to Disclose their Aggressive Tax Planning Arrangements).
- **Forum on Harmful Tax Practices (FHTP)**, in relation to action 5 (Counter Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance); and
- **Task Force on Digital Economy (TFDE)**, established by the CFA to carry out the work in relation action 1 (Address the Tax Challenges of the Digital Economy).

The ATO has stated of the OECD BEPS Action Plan:[482]

> *Of course it is unrealistic to consider that BEPS can be 'solved' during the two years of the Action Plan. After all, implementation will ultimately be a matter for each*

[481] OECD, 'About BEPS', http://www.oecd.org/tax/beps-about.htm
[482] Mark Konza, 'Base erosion and profit shifting – a progress report on G20/OECD action', Melbourne, ATO Media Centre, 25 September 2014, https://www.ato.gov.au/Media-centre/Speeches/Other/BEPS---a-progress-report-on-G20/OECD-action/

G20/OECD member post-2015. Each country will need to assess what changes to apply to domestic legislation and how existing tax treaties will be affected.

The G20 re-stated their commitment to the BEPS Action Plan at the Leaders' Summit in Brisbane in November 2014, stating:[483]

We welcome the significant progress on the G20/OECD Base Erosion and Profit Shifting (BEPS) Action Plan to modernise international tax rules. We are committed to finalising this work in 2015, including transparency of taxpayer-specific rulings found to constitute harmful tax practices. We welcome progress being made on taxation of patent boxes.

However, the Synod is concerned at the limited role developing countries have been given in the BEPS Action Plan.

The G20 Leaders' Summit communique stated that "We welcome deeper engagement of developing countries in the BEPS project to address their concerns."[484]

The Synod shares the concern of the BEPS Monitoring Group[485] that the OECD in the BEPS Action Plan has drifted from the G20 aim of "Profits should be taxed where the economic activities deriving the profits are performed and where value is created"[486], to the elimination of 'double non-taxation'.[487] The shift is important as the OECD goal can be achieved by simply ensuring all profits are taxed somewhere, but that somewhere would not have to be in the place where the economic activities deriving the profits are performed and where value is created.

By September 2014, the BEPS Action Plan working groups had provided seven reports on schedule with the timetable outlined above. We share the view of the BEPS Monitoring Group that governments need to begin to align their tax systems in the direction of the reforms indicated by the BEPS Action Plan.[488]

The BEPS Action Plan aims to remedy flaws without reconsidering the underlying principles of the system, such as the residence-source split. Such reconsideration is unavoidable in our view, as has been starkly shown by the current US difficulties in trying to deal with firms relocating their headquarters abroad ('inversions'). Trying to reassert residence taxation by the home country through a revival of rules on controlled foreign corporations (CFCs), which is on the coming year's BEPS agenda, cannot provide a rational method of taxing firms which are becoming increasingly multinational; today's globalised economy calls for a more global approach to apportioning multinational's profits.[489]

We share the view of the BEPS Monitoring Group that the underlying cause of BEPS is the separate-entity/arm's-length principle which the OECD itself has increasingly entrenched over the last two decades; it insists on treating the national operations of MNEs as if they were independent of each other, whereas in reality they operate as an integrated whole under central direction. This principle creates a perverse incentive for MNEs to organise

[483] G20 Leaders' Communique, Brisbane Summit, 15-16 November 2014, p. 2.
[484] G20 Leaders' Communique, Brisbane Summit, 15-16 November 2014, p. 2.
[485] The BEPS Monitoring Group is a group of experts on various aspects of international tax, set up by a number of civil society organisations which research and campaign for tax justice including the Global Alliance for Tax Justice, Red de Justicia Fiscal de America Latina Y el Caribe, Tax Justice Network, Christian Aid, Action Aid, Oxfam and Tax Research UK.
[486] G20 Leaders' Communique, Brisbane Summit, 15-16 November 2014, p. 2.
[487] BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, p. 1.
[488] BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, p. 2.
[489] BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, p. 3.

themselves as complex corporate groups with often hundreds of affiliates including many formed in jurisdictions that facilitate profit shifting and tax avoidance.[490]

Some of the proposals from the OECD BEPS Action Plan, which can be implemented simply by changes to national law or policy, could be acted on immediately by states, notably those on hybrids.[491]

Action 1: Addressing the tax challenges of the digital economy
On Action 1, the digitalisation of the economy has made clear the need for new thinking for tax system design. It has accelerated changes in the core profit-generating activities of business, enabling restructuring both within firms and between them and contractors, as well as important shifts in relationships between producers and consumers. These trends greatly extend the ability of firms to make profits in countries without themselves having a significant physical presence, and to restructure corporate groups in ways which result in attribution of profits in countries where they would be lightly taxed.[492]

The OECD has taken the view that digitalisation affects the whole economy, so rules need to be reformed which would not be ring-fenced to a specific sector. Some necessary reforms should result from work on the specific Action Points, especially on treaty abuse, Controlled Foreign Corporations (CFCs), Transfer Pricing (especially regarding valuation of data dealing with global value chains), and reconsidering the definition of a permanent establishment (PE) (for example, where a firm also has marketing, warehousing or delivery activities). The OECD considers that these should deal with most of the cases which have given rise to public concern, relating to large internet-based companies, since they generally do have subsidiaries in countries where they have significant sales.[493]

However, it also recognizes that there are `broader tax challenges', particularly relating to collection of sales tax in online transactions, and as there are questions raised by (i) data collection from customers, (ii) characterization of income from digital transactions, and (iii) the important issue of tax nexus where there is little physical presence. These questions are inter-related, and a framework has been agreed for analyzing them through further technical work. As regards the PE definition, a number of options have been identified, including the proposal for a concept of Significant Presence. The Task Force on the Digital Economy will continue with this work, aiming to conclude in 2015. However, it considers that evaluation of the urgency and scope of further action on this issue should take place only after all the work on the BEPS project is complete.[494]

In the view of the BEPS Monitoring Group, an important aspect which was not sufficiently brought out in the OECD report was the changing nature of producer-consumer relations, which goes much further than simply gathering of data about customers. In the view of the BEPS Monitoring Group this necessarily requires a re-evaluation of the traditional Residence and Source concepts and income attribution between them. Re-evaluation of the application of the existing PE concept, under Action point 7, to situations where the firm also has a presence through subsidiaries conducting related activities, is welcome. In the view of the BEPS Monitoring Group, this should entail reconsideration of the so-called Authorized OECD Approach (AOA) to the PE. The AOA was agreed relatively recently by the OECD, although it was rejected by developing countries; it has been implemented by protocols to treaties among some OECD countries.[495]

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490 BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, p. 3.
491 BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, p. 1.
492 BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, p. 3.
493 BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, pp. 3-4.
494 BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, p. 4.
495 BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, p. 4.

Nevertheless, this will not be sufficient, and the BEPS Monitoring Group welcomed the proposal to examine the actual PE definition both in parallel with and as a follow-up to the OECD BEPS project. In the view of the BEPS Monitoring Group, it relates closely to other issues not included in the OECD project and of particular concern to developing countries, especially taxation of services. Digitalization has significantly increased the ability of firms to shift from discrete sales of physical commodities to more long-term relationships with customers in the form of services, and hence often with little or no physical presence. It is this underlying change that leads to both the problem of characterization and the lack of direct physical presence. For example, an internet-based publisher can service subscribers all over the world using freelance authors in each country to supply local content. It is nevertheless characteristic of services that they generally entail close relationships with clients, often indeed a two-way relationship with significant input from the client. Services firms operating digitally also generally require other local inputs to support their relations with customers, such as payment facilities, business agents and consultants with local knowledge, which may be done by third parties contractually.[496]

Action 2: Neutralise the effects of Hybrid Mismatch Arrangements
The underlying problem is that interest expenses are generally considered as deductible from business profits, so reduce the tax base in Source countries, while tax treaties limit the power to levy withholding taxes at source on interest payments. However, this may apply even if such payments are not taxed as income of the entity receiving them (deduction with no inclusion). Further, companies can organize their financial structure so as to obtain a deduction in two countries (double deduction or `double dipping'). The Action Plan aims to tackle problems caused by interest deductibility through a number of its action points. Action 2 deals only with where either the entity or the instrument are `hybrids', that is treated differently by the law in the two countries.[497]

The OECD proposes complex provisions on hybrids both for inclusion in tax treaties and for domestic law. The scheme provides that generally the source state would be allowed to refuse a deduction if, or to the extent that, the payment concerned is not taxed by the receiving state; but if it does not do so, the receiving state may tax it. The measures are considered to be complementary, so capable of application without any need for coordination. Some have argued that the recipient should have the primary jurisdiction to tax, but the OECD has decided that the source state should have first bite; rightly, in our view, as it has the stronger incentive to ensure tax is levied. The proposals were cast very widely, affecting entities which are not integrated MNEs such as investment funds, and did not adequately consider hybrid instruments used for valid reasons such as regulatory requirements for banking (for example, debt convertible into equity). The OECD has now conceded that such questions need further work.[498]

We agree with the BEPS Monitoring Group that the proposals are complex, yet deal with only one rather specific aspect of the underlying problem. For example, they do not deal with Belgium's notional interest deduction regime providing an allowance for corporate equity, which is left to be dealt with (if at all) as a `harmful tax practice'. To be properly effective, they would require coordination, at least so that the source state could have adequate information on the tax treatment in the receiving state.[499]

However, we agree with the BEPS Monitoring Group that what is needed is a more comprehensive approach to deal directly with the underlying problem of interest deductibility.

[496] BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, p. 4.
[497] BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, p. 5.
[498] BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, p. 5.
[499] BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, p. 5.

In practice, MNEs organise their financial structures centrally, as demonstrated by some of the arrangements exposed by the Luxembourg leaks. The clearest and simplest approach to this basic problem would be to allow each country to limit deductions by treating a multinational's debt on a consolidated basis, and apportion it to entities in each country by an appropriate criterion (such as EBITDA). The details of such an approach could be developed in the forthcoming work on Action Point 4 concerning limitation of deductions, building on provisions which some countries have already adopted in their national laws. If appropriately designed it would provide both a simpler and a more coherent solution to the underlying problem, and one that would more comprehensively deal with both hybrids and aspects which would otherwise be covered piece-meal by a range of other measures (such as harmful tax practices, limitation of benefits clauses, transfer pricing provisions on financial instruments).[500]

On the issue of hybrid mismatch arrangements, in September 2014 the ATO stated:[501]

> *Whilst Australia has a number of audit cases involving potential hybrid instrument and entity mismatch arrangements, we do not currently have anti-hybrid mismatch rules. We are currently seeking feedback from our operations teams to identify and consolidate examples of hybrid mismatch in order to establish the level of risk, before identifying any potential action required.*

However, it is of some concern that:[502]

> *Both the ATO and Treasury support the approach that the rules should only apply to deliberate mismatches (for example, related party and structured arrangements) and exclude unintended mismatches.*

The Synod is not clear that there is a strong line between a clear deliberate mismatch and one that was not intended. Such an approach has the potential to invite tax planners to devise and promote schemes that appear to be unintended mismatches.

Action 4: Interest Deductions and Other Financial Payments
Under Action 4 of the OECD BEPS action plan covering 'Interest Deductions and Other Financial Payments' the Synod is supportive of the OECD's main proposal, that countries should introduce a limit on such interest deductions based on the consolidated net interest expense of the whole multinational corporate group to third parties, apportioned to each group member according to its earnings before tax, interest, depreciation and amortisation (EBITDA).

However, the Synod agrees with the BEPS Monitoring Group more attention should be paid to the problem of divergence between the standards for financial accounting and those for taxation. Since consolidated financial statements will at least initially be used, we agree with the BEPS Monitoring Group that companies should be required to identify and adjust for any material differences caused by inconsistent financial accounting rules and differing accounting and tax treatments of significant items, at both the group and entity levels. Any allocation of net interest expense based on group accounting must be based on data drawn from the consolidation process where (i) all intra-group transactions have already been eliminated from consideration and (ii) the accounts of subsidiary entities have, if necessary, been restated from the local accounting standards to those of the group financial statements.

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[500] BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, pp. 5-6.
[501] Mark Konza, 'Base erosion and profit shifting – a progress report on G20/OECD action', Melbourne, ATO Media Centre, 25 September 2014, https://www.ato.gov.au/Media-centre/Speeches/Other/BEPS---a-progress-report-on-G20/OECD-action/
[502] Mark Konza, 'Base erosion and profit shifting – a progress report on G20/OECD action', Melbourne, ATO Media Centre, 25 September 2014, https://www.ato.gov.au/Media-centre/Speeches/Other/BEPS---a-progress-report-on-G20/OECD-action/

In the longer term, the Synod agrees with the BEPS Monitoring Group that the OECD work on the development of an international standard for tax accounting for such purposes, which could build on the work already done in the EU's Common Consolidated Corporate Tax Base.

The Synod welcomes that the adoption of any allocation rule entails a move away from the separate entity principle, but in this case only in relation to charging for costs. We support an apportionment approach in general, since it is in line with business reality, and results in rules which are much easier to administer. In the case of interest, the Synod supports a cost apportionment since (i) allocation based on earnings reflects economic activity and hence to some extent benefit; and (ii) evidence shows that this method would restrict interest deductions to a level which will normally be well below that resulting from the interest cap or thin capitalisation rules that countries currently apply.

However, the Synod would generally favour a move to more comprehensive profit apportionment solutions. Hence, the Synod strongly encourages the systematisation and expanded use of the profit split method, which fairly and easily apportions both costs and revenues. This would be the most effective way to achieve the aims of the BEPS project as laid down by the G20 leaders, to ensure that multinationals are taxed "where economic activities take place and value is created".

Action 5: Counter Harmful Tax Practices more effectively taking Account of Transparency and Substance

We share the concern of the BEPS Monitoring Group that little progress has been made so far on addressing Harmful Tax Practices.[503]

Many countries have been tempted to offer special tax advantages or regimes which in effect work in a beggar-thy-neighbour way, undermining the tax base of other countries. These may facilitate not only profit shifting but also base erosion, since the economic advantages to the countries providing the tax breaks (although they may be significant) are overall less than the taxes lost by the countries harmed. Such practices create a race to the bottom in corporate taxation. Indeed, sometimes countries sacrifice their own tax revenues to stave off threats of relocation by MNEs.[504]

The OECD initiated a project to try to deal with these `harmful tax practices' (HTPs) in 1998. It formulated a number of criteria for defining what tax breaks could be considered as `harmful', and set up an intergovernmental forum to identify and evaluate relevant national measures. However, the initiative soon ran into political objections, especially from the then US administration, that trying to limit tax breaks infringed the sovereign right of states to decide their own tax systems. It culminated in a report in 2006 which evaluated 47 preferential tax regimes that had been identified as potentially harmful; this found that 18 had been abolished and 14 amended to remove their potentially harmful features, while another 13 were found not to be harmful, as were a number of holding company regimes additionally considered. The only one considered harmful was that of Luxembourg, which the Luxembourg government said it would defend under European law. The HTP project then refocused on information exchange mainly from tax havens, and the work of the Forum on HTPs was effectively suspended.[505]

The EU began a parallel process on HTPs based on a Code of Conduct, also aiming to evaluate preferential tax measures according to a number of criteria, including whether they relate to non-residents, are ring-fenced from the domestic market, are granted `even without

503 BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, p. 2.
504 BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, p. 6.
505 BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, p. 6.

any real economic activity and substantial economic presence' in the state concerned, involve rules for profit determination which depart from internationally accepted principles, and involve rules lacking transparency, including where they are relaxed administratively in a non-transparent way. The application of these criteria has been done for some fifteen years by an intergovernmental Group working in a rather non-transparent way. It had some success at first, greatly assisted by the activation by the European Commission of its legal powers to challenge some such measures if they could be considered to be state aids. The Code Group managed to identify and list potentially harmful measures, evaluating them and specifying the harmful ones which should be phased out. Subsequently, states became more sophisticated in devising measures which could fall outside the criteria, particularly the `innovation box' or `patent box', which offers a low tax rate for royalties from intellectual property. The Group failed to agree that this was incompatible with the Code. This encouraged other countries also to adopt such a provision, notably the UK, and such a measure is now under active consideration by others even outside the EU, for example Switzerland. The EU Council of Ministers has agreed to re-evaluate criterion (iii) relating to economic substance, while urging that this be done in conjunction with the OECD BEPS project. The OECD must also find solutions which are compatible with EU law, that is which do not involve states treating foreign companies in ways which might be considered discriminatory. It must also find a way to persuade non-OECD and non-G20 countries to fall into line. The original 1998 report included a discussion of `defensive measures', that is sanctions. It rightly pointed out that it is difficult for an individual country to take such measures, since the targeted activity can simply move elsewhere, so it suggested that `a multilateral approach is required and the OECD is the most appropriate forum to undertake this task' (para. 138). However, this suggestion was so controversial that it was quietly forgotten.[506]

The BEPS project action point 5 entails revamping the Forum. However, it seems that a new review of HTPs was begun in 2010, some results of which are given in this report. Of 30 regimes reviewed, nine have been found not harmful, six are still under review, while 15 concern innovation incentives, which would need to be considered under the revamped approach. Work on this issue was done in secret, attempting to insulate it from business pressures, but as a result also hindering public debate. Progress has been slow, evidently due to a sharp conflict and extended debates over the `innovation box'.[507]

The OECD report proposes criteria on transparency, requiring states to make available to each other their administrative rulings, based on a procedure for `spontaneous' information exchange, a legal basis for which already exists in tax treaties. Hence, this should begin immediately.[508] But the actual description of the system (from p. 38 of the OECD report) shows that each state will decide for itself when it should notify, by a "spontaneous" exchange of information. The procedure is supposed to reduce the state's discretion by requiring it to apply "filters" to decide when to supply the information – but it still just decides for itself.[509]

Most of the time has been taken up with defining the criteria for `harmful', especially in relation to `substantial activities, and as applied to the patent box. The discussion has focused on a proposal to apply an `economic nexus' approach to deal with the `substantive activities' issue especially in relation to `innovation boxes'. This has been opposed apparently by a small group of states, from the OECD (Luxembourg, the Netherlands, Spain and the UK). There is no consensus, and hence no agreement, on this point. However, the

[506] BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, pp. 6-7.
[507] BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, p. 7.
[508] BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, p. 7.
[509] Sol Picciotto, 'Luxembourg's Sweetheart Deals: Could the OECD Stop Them?', http://www.taxjustice.net, 9 November 2014.

BEPS Monitoring Group understand that the OECD has a legal opinion from the European Commission, supported by its own advice, that the `economic nexus' concept could be compatible with EU law.[510]

In many ways this issue goes to the heart of the dilemma posed by the approach adopted by the G20 and the OECD to the BEPS problem. The mandate from the G20 to reform tax rules to ensure that MNEs are taxed according to `where economic activities take place and value is created' necessarily entails closer coordination of tax rules. Hence, it could be said to involve limits on state sovereignty, which the G20 has also said should be preserved. Yet without such closer coordination states have been losing their power to tax MNEs effectively.[511]

The proposals on greater transparency are long overdue. However, they rest on weak foundations, since they largely rely on self-reporting by states.[512] The bottom line is that under the OECD proposed approach, states can't even agree when to notify each other of secret rulings, and will only do so voluntarily.[513] We nevertheless hope they will prove effective. No doubt some states have been encouraged to accept this need by the legal proceedings commenced by the European Commission against Ireland, Luxembourg and the Netherlands.[514]

The proposed approach of defining criteria for HTPs and evaluating measures as they are proposed or adopted is toothless, so will be inadequate. This has been shown by the previous experience. The EU project had a little more success than the OECD's, largely because the EU's Code procedure is backed by the European Commission's legal powers to challenge state aids. The OECD procedures lack sanctions, especially since the suggestion in the 1998 report of `coordinated defensive measures' was buried, and has not been resuscitated in this report. Furthermore, the OECD would need to extend its monitoring to non-G20 countries, such as Singapore or the UAE, over which it has even less effective power. Relying largely on voluntary cooperation, this approach becomes a game in which the participants judge each other's conduct, under rules which they have more incentives to relax than to strengthen. Participation in the Forum helps countries learn from each other how to design new and more ingenious tax breaks.[515]

Within the limitations of this approach, the proposed approach to `economic nexus' adopts a subtle solution to defining `substantial activities'. It aims to deal with the problem that this is not a binary question but a relative one. It is a matter of whether the profits attributed are reasonably related to the actual economic activities and value created. The same issue underlies other Action Points, such as treaty abuse and transfer pricing. However, as with the scheme for dealing with hybrids, the proposed rules would be highly complex, yet provide at best a partial solution. It remains to be seen whether the inability to overcome the objections of a few states even to this proposal can be overcome without reviving the possibility of concerted counter-measures. If difficulty has been experienced in reaching agreement under this approach on special regimes such as the patent box, solutions will be impossible for low-tax regimes of a general character already in force in some states and under consideration in others.[516]

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[510] BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, p. 7.
[511] BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, p. 7.
[512] BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, p. 7.
[513] Sol Picciotto, 'Luxembourg's Sweetheart Deals: Could the OECD Stop Them?', http://www.taxjustice.net, 9 November 2014.
[514] BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, p. 7.
[515] BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, pp. 7-8.
[516] BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, p. 8.

In our view, however, the problem of the `innovation box' should be tackled directly by stating that countries which wish to encourage innovation and research and development (R&D) should do so by allowing deduction of actual expenditures on people and assets. As the report points out, such `front end' regimes directly link company expenditures to tax benefits. The proposed `economic nexus' scheme attempts through its elaborate rules to extend these principles. However, allowing such schemes even subject to an economic nexus requirement would not only be ineffective, but in our view unjustified. If it is considered desirable to offer tax advantages to perform R&D, appropriate tax allowances are an adequate mechanism. The argument that companies deserve even greater contributions from the taxpayer if an investment in R&D generates exceptional income seems hard to justify. Innovative companies derive exceptional profits from the first-mover advantage, but also importantly from patent protection, which is a state grant of a monopoly. To grant on top of this a low tax rate, especially on income which could reduce the tax base resulting from economic activities (including marketing and sales) taking place in other countries, is a direct encouragement for firms to devise BEPS strategies.[517]

More widely, the underlying problem of competition to offer corporate tax advantages can only be dealt with effectively by reforming the substantive rules so that MNEs can indeed be taxed `where economic activities take place and value is created'. This entails acceptance of the principle of taxation of multinationals as unitary firms. One of the most important areas in which this principle should be applied is so-called intangibles. To allow firms to `attribute' income streams to particular intangible `assets', and apply lower tax rates to such income streams, is simply a recipe to encourage base erosion and profit shifting to continue. The countries which have adopted such regimes should be pressured to end them, if necessary by coordinated counter-measures.[518]

This issue again clearly shows why a better approach to taxing companies where economic activities take place would be extension of the profit split method. The use of the profit split method applied with concrete and easily determinable objective allocation keys would be much easier to administer and far less intrusive both for states and enterprises, and would also leave states free to decide their own tax rates, as well as investment allowances.

It should be kept in mind however that IP regimes are only one type of new special regimes. The OECD should quickly proceed with the review of other new regimes that are potentially harmful as well.

An important type of favourable regime is one offering advantages for its use a parent company home jurisdiction, due to differing criteria for tax residency. For those jurisdictions that include one or more forms of management and control within their residency definition, it is fair to say that the combination of taxpayers' abilities to factually control where they take various corporate actions, and the difficulty for tax authorities to look for and identify indices of management and control for companies organized elsewhere, means that many companies established in convenient jurisdictions can practically escape residency in any country where they might have operations or from which their operations are directed. For those jurisdictions that use solely the place of incorporation to establish residency (most notably the US), multinationals have blatantly conducted significant operations through tax haven subsidiaries while openly managing those operations from within the U.S. Perhaps Apple Operations International is the most well-documented example of this.

These deficiencies regarding tax residency suggest that the BEPS project should consider making some recommendations regarding standardization of the criteria on which tax residency will be based. In addition, the OECD could consider developing 'best practices'

[517] BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, p. 8.
[518] BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, p. 8.

regarding what tax authorities should be alert to and how they could go about identifying companies arguably resident within their respective jurisdictions and supporting such residency determinations. In addition to using favourable regimes as a home jurisdiction for a parent company, a second use of favourable regimes is as an intermediary company, for purposes such as securing treaty benefits, changing the character of income, or deferring home country taxation. Such intermediary uses are being considered through the BEPS Action Points on treaty abuse, the use of hybrids and CFCs.

Many abusive tax structures have in common that they lack economic substance. However, companies are increasingly trying to get around this by adding (just) enough substance to meet all applicable tests and prevent the impression of an empty shell. Countries may even require them to do so, for example to avoid measures introduced by other countries on limitation of treaty benefits. Yet this does not change the harmful effect of such structures on other countries. It still induces profit shifting and causes strategic responses, leading to a race to the bottom. Thus, it should be explicitly recognized that tax planning structures, and special regimes, can be harmful even if they do have some economic substance. The same applies to lack of transparency.

By contrast, it seems that current efforts hardly seek to identify regimes on the basis that they encourage purely tax driven operations. This criterion could be applied more broadly. because it might capture various types of regimes that produce harmful effects, even if they do require some economic substance and are fully transparent.

With regard to extending the approach, the Forum should also assess general tax regimes. As the OECD and EU initiatives focussed on preferential tax regimes in member states, there has been a shift from preferential tax benefits to general tax regimes that provide largely similar tax advantages. A typical example is the shift in Ireland from special financial services and manufacturing regimes, first with long tax holidays and then with a preferential tax rate of 10%, to a general tax system with an overall low tax rate of 12.5%. Another example is the Belgian system of notional interest deductions. This system applies to all companies and is not a special regime. However, in international structures this can easily be abused to create mismatches, although they are not caught by BEPS Action 2, and it is also promoted as such. Switzerland is currently considering replacing its preferential holding and mixed company regimes by either a low overall tax rate or a notional interest deduction system as well. In all these examples, although the abolition of 'ring-fenced' tax regimes brings the tax systems in line with the HTP criteria, the harmful effects on other countries do not go away. On the contrary, as the general regimes that replace them apply to all companies, the effects probably become even larger.

The BEPS project must therefore find a way of assessing negative spillover effects of general tax systems as well. Otherwise, it will not be able to effectively address the race to the bottom in corporate taxation. Focussing on preferential regimes alone is no longer enough.

There are some indications that the project may already be moving in that direction. The original description of the work under Action 5 mentions *'compulsory spontaneous exchange on rulings related to preferential regimes'*. In recent BEPS progress webcasts, it was confirmed that this will be extended to all relevant rulings, including rulings that do not relate to preferential regimes. Thus, the Synod asks that the Australian Government encourage the OECD to extend other aspects of its HTP approach in the same way as well.

Action 6: Prevent Treaty Abuse

Tax treaties generally restrict the power of source states to tax business profits and to apply withholding taxes on payments such as dividends, interest, royalties or fees. States accept these restrictions in order to attract inward investment, and on the understanding that such payments would be subject to the normal taxation in the recipient treaty-partner state. However, MNEs can take advantage of treaties in various ways to obtain the benefits of reduction of source taxation without being taxed by the treaty partner, which is an unintended result of tax treaties.[519]

The Australian Treasury has recognised how treaties can be used to undermine the Australian tax system:[520]

> *where a tax treaty partner is not exercising its right to tax this is conceptually equivalent to having a tax treaty with a tax haven. As such, gaps, mismatches and inconsistencies in tax rules around the world can pose risks to the integrity of Australia's tax system and the international tax system generally.*

One key method of misusing treaties is `treaty shopping', by setting up intermediary entities in states with appropriate treaties to receive such payments, which can be passed through to low- or zero-tax states, leaving little or no profit in the intermediary entity to be taxed. This is one of the key techniques which creates `stateless income' which has not been taxed anywhere but is available to a multinational for reinvestment abroad. Some states encourage treaty shopping by offering advantages such as exemption of foreign-source income, while actively negotiating treaties. States which became aware of the problem in the 1970s adopted counter-measures, such as the `limitation of benefits' (LoB) clause developed and refined over a period by the US. Others have preferred a more general `main purpose' provision, which is more flexible but also more discretionary.[521]

More widely, countries can try to prevent unintended benefits by enacting anti-abuse provisions. This can be done in national law, but courts may be reluctant to use a general anti-avoidance rule to block the application of a specific treaty provision. It is therefore preferable to ensure that the treaties themselves also include a clear statement of their purposes and objects and an anti-avoidance rule.[522]

The OECD proposes model treaty provisions for both a LoB and a Main Purpose clause. States could choose either or both, but the OECD proposes a minimum standard. In addition, it makes recommendations regarding domestic anti-abuse provisions, and proposes that it should be made clearer that tax treaties are aimed at preventing both double taxation and double non-taxation by inclusion of an appropriate statement in the Preamble of such treaties.[523]

The ATO has noted:[524]

> *The OECD's published report has proposed linking rules, which would be divided into a primary rule (to apply whenever a hybrid mismatch occurs) and a secondary or defensive rule (to apply where the first country does not neutralise the mismatch). Further ordering rules would be developed to prevent double taxation. The effect of having both a primary and defensive rule is that a country does not need to rely on the domestic laws of another country in order to neutralise hybrid mismatches.*

Further:[525]

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519 BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, pp. 8-9.
520 Australian Government Treasury, 'Implications of the Modern Global Economy for the Taxation of Multinational Enterprises', Issues Paper, May 2013, p. 11.
521 BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, p. 9.
522 BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, p. 9.
523 BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, p. 9.
524 Mark Konza, 'Base erosion and profit shifting – a progress report on G20/OECD action', Melbourne, ATO Media Centre, 25 September 2014, https://www.ato.gov.au/Media-centre/Speeches/Other/BEPS---a-progress-report-on-G20/OECD-action/

Australia is supportive of the work in developing internationally agreed anti-treaty abuse rules that all countries can apply.

The specific anti-abuse rules provided for a minimum standard with a Principal Purpose Test (PPT) either alone or with a Limitation of Benefits (LOB) test, or a LOB test with a modified PPT to prevent treaty shopping. We have a strong interest in the development of a PPT because of the difficulties in applying Part IVA to complex offshore arrangements. Australia does, of course, have a LOB test in two treaties and a limited PPT in one other.

The Synod agrees with the BEPS Monitoring Group that a statement in the preamble in a treaty is too weak, as such statements are rarely used to counter what may seem to be a rational literal interpretation of a substantive treaty provision. Tax treaties need to begin with an article which clearly states that their purpose is to ensure that persons and companies are taxed where their economic activities take place and value is created. The aim of the substantive provisions should be to ensure this. One or more suitable anti-abuse clauses can be helpful, but it is unrealistic to expect them to carry too much weight, especially if the substantive provisions are ineffective. We agree that there are advantages and disadvantages to both the proposed measures, but the failure to agree on a single effective measure is problematic. The targeted LoB provision is detailed and complex, more precise, but therefore offering possibilities for circumvention, while the Main Purpose provision is more flexible and hence potentially comprehensive, but also more discretionary and hence liable to be arbitrary and potentially more prone to abuse. In view of the disagreement, a `belt and braces' approach seems the only solution, combined with a minimum standard as proposed. Nevertheless, it is not clear that this will reduce the problems posed by either of the alternatives, and combining them could multiply those problems. We nevertheless hope that all OECD and G20 countries will comply with their commitment to adopt suitable provisions promptly, and complement these with spontaneous exchange of information by the residence state on structures to which the anti-abuse provisions may apply. The G20 faces a larger challenge in trying to ensure wider adoption of these provisions. This is one of a number of issues where closer coordination especially with developing countries is essential, presumably through the proposed Multilateral Convention. If a non-G20 developing country has a strong preference for a specific provision, we suggest that the choice of the developing country should be decisive in determining the type of provision in its treaties with OECD and G20 partners. Expecting developing countries to have to apply a range of different anti-abuse measures would unnecessarily strain their administrative capacity.[526]

Action 8: Assure that Transfer Pricing outcomes are in line with Value Creation – Intangibles Phase 1

As noted above, transfer pricing is the area which most clearly reveals the fundamental flaws in the current tax rules. These can be traced to the separate entity/arm's length principle, which implies an unrealistic and unworkable standard, since MNEs only exist because of the benefits of synergy they can obtain by operating in an integrated way. In particular, the use of `comparables' in establishing standards for transfer prices under the arm's length principle has been shown to be deficient in both theory and practice, due to the integrated nature of MNEs and their advantages of superior know-how and technology, and economies of scale and scope. Three of the nine substantive points in the BEPS Action Plan aim to deal with aspects of transfer pricing.[527]

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[525] Mark Konza, 'Base erosion and profit shifting – a progress report on G20/OECD action', Melbourne, ATO Media Centre, 25 September 2014, https://www.ato.gov.au/Media-centre/Speeches/Other/BEPS---a-progress-report-on-G20/OECD-action/

[526] BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, pp. 9-10.

[527] BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, p. 10.

For over three decades it has been understood that the major problematic area in transfer pricing involves so-called intangibles, for several reasons. A major competitive advantage of most MNEs is their control of know-how and advanced technology. This generally results from their size and ability to combine large-scale innovative activity, as well as simply to acquire such technology by purchasing rights or teams of innovators. A firm's knowledge or know-how is very much a result of synergy, and it is very hard to value the different contributions of different parts of the firm to that whole. This is so even when such knowledge can take the form of intellectual property, since this concept creates a misleading notion of the nature of innovation or creativity as individualized, episodic and discrete, instead of collective, continuous and cumulative. Today, such research is generally carried out by MNEs through worldwide teams operating in a coordinated way. Furthermore, basic research must be closely linked with product development and marketing, and in fact companies spend far more on these than on research.[528]

This has become an intractable issue because the OECD approach has exacerbated the difficulties created by the separate entity/arm's length principle, by contributing to making a fetish of the concept of `intangibles'. The innovation and know-how which are the main sources of competitive advantage for companies today essentially flow from the people they employ.[529]

The OECD began to recognize the special problem of intangibles over twenty years ago, but has made only feeble attempts to deal with it. The issue of intangibles is central, and a project begun already in 2010 has finally resulted in a draft revised chapter on intangibles for the Transfer Pricing Guidelines. The proposals in the discussion draft on intangibles were long-overdue. They seemed to recognize the need to move away from the fictions of ownership, contract and provision of capital to justify transfers within multinational corporate groups, which have long been a primary source of BEPS. Not surprisingly, the drafts were the subject of a most intensive lobbying effort by tax advisers, many of who seemed to believe there is a reality in the fictions they themselves create. Regrettably, the OECD report on this action item seems to have yielded to many of their arguments.[530]

The report presents a new chapter VI on intangibles for the OECD Transfer Pricing Guidelines which is 66 pages long, plus a 36-page Annex of examples. The core parts of the draft on intangibles is at this stage treated as provisional, pending the work to be done next year. Mastering its intricacies will be a daunting challenge for tax officials especially in developing countries, but no doubt continue to provide lucrative work for tax advisers. The draft begins by affirming that `[l]egal rights and contractual arrangements form the starting point' (para. 6.35); but it goes on to say that they `serve simply as reference points', so must be `combined with the identification and compensation of relevant functions performed, assets used, and risks assumed by all contributing members' of the corporate group. The discussion of how to evaluate the various ways in which functions, assets and risks may be deployed takes many pages, but makes clear that it is basically a pragmatic factual analysis.[531]

Accepting the starting point of fictitious legal ownership will continue to encourage MNEs to convert the innovations they generate into potentially highly valuable property rights, and use fictitious transfers to related entities to design complex tax-saving structures. This puts great weight on the methods used to decide the appropriate remuneration for the various `functions, assets and risks'. Yet here the proposal remains unclear and full of ambiguities, inconsistencies and even contradictions. It states in general terms that `depending on the

[528] BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, p. 10.
[529] BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, p. 10.
[530] BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, p. 10.
[531] BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, pp. 10-11.

specific facts' any of the five accepted transfer pricing methods may be appropriate, and then adds that `other alternatives may also be appropriate' (para.6.133). However, in discussing the use of comparables it rightly points out that `intangibles often have unique characteristics' (6.113), and hence that `the identification of reliable comparables in many cases involving intangibles may be difficult or impossible' (6.143). Furthermore, `One sided methods, including the resale price method and the TNMM, are generally not reliable methods for directly valuing intangibles' (6.138). The logical conclusion is that the profit split method should be used, but the draft is reluctant to say so, and says little or nothing about how in practice the analysis of "value creation" factors could guide application of profit split.[532]

The proposals still refuse to abandon the fictitious concepts of ownership and risk within a multinational. The new emphasis on `functions, assets and risks' seems only to add further complexity to the detailed factual analyses required, which will add greatly to the burdens of tax administrations. It is nevertheless likely that there will be a further shift in practice to the use of the profit split method. Yet, much more work needs to be done on regularizing and systematizing this method, especially by (i) developing recommendations for common tax accounting standards, and (ii) defining suitable allocation keys. We hope that this can be done in the next phase of the project.[533]

The OECD is also committed to considering `special measures either within or going beyond the arm's length principle' (Action Plan p.20). So far these seem to be envisaged only for special cases or exceptional circumstances, without any clarification yet of what these might be. The OECD still religiously proclaims its adherence to the totem of the `arm's length principle, even though this is interpreted as allowing five accepted methods of application which differ widely, and further alternatives are under consideration. The total incoherence of transfer pricing rules remains the most blatant indicator of the crisis of the current system. Unless a better approach can be developed in the next year, the BEPS project would have to be judged a failure.[534]

Action 13: Re-examine Transfer Pricing Documentation and Develop a Template for Country-by-Country Reporting

There are two distinct problems here, both caused by the separate entity/arm's length principle. This principle means that countries are supposed to treat the subsidiaries and branches of a MNE in their country as if they were independent of the others in the multinational corporate group. The consequence is, on the one hand that tax authorities find it hard or impossible to construct a clear picture of the group as a whole, while on the other they need a lot of information on transactions between group members in order to adjust transfer prices according to the arm's length principle.[535]

The OECD initially confused the two issues, by trying to combine the development of the Country-by-Country Reporting template with transfer pricing documentation. The proposals substantially rectify this, by proposing three levels of reporting: (i) a Country-by-Country report, (ii) a Master File, and (iii) a Local File. In principle, the first should be a general risk-assessment tool relating to all BEPS issues, while the other two deal specifically with transfer pricing documentation. However, this distinction is unfortunately not made fully clear in the OECD report. First, implementation is proposed by means of a revised section in the Transfer Pricing Guidelines, although some phrases are added stating that the Country-by-Country report might also be useful for other BEPS issues. Secondly, it seems that some countries, especially non-OECD G20 members, would like to include some transfer pricing

[532] BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, pp. 10-11.
[533] BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, p. 11.
[534] BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, p. 11.
[535] BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, pp. 11-12.

documentation as part of the Country-by-Country reports. This is apparently because they find it difficult to obtain such information otherwise.[536]

A `model template' for the Country-by-Country report has been agreed, to provide an overview of the MNE as a whole broken down by jurisdiction giving aggregate data by jurisdiction on (i) revenues (separating those from related and unrelated parties), (ii) profit/loss before income tax, (iii) income tax paid (cash), (iv) income tax accrued in current year, (v) stated capital, (vi) accumulated earnings, (vii) number of employees, (viii) tangible assets (non-cash). It also requires a listing of all constituent entities in the multinational group together with their jurisdiction of incorporation and residence and main business activities. Separate annexes describe the information which should be included in the Master File and Local files. The Master File requires information in five categories: (i) the MNE group's organisational structure; (ii) a description of the MNE's business or businesses; (iii) the MNE's intangibles; (iv) the MNE's intercompany financial activities; and (v) the MNE's financial and tax positions. The Local File would provide more detailed information relating to specific intercompany transactions.[537]

The report envisages that all reports would be delivered to tax administrations. Tax administrations are required to take `all reasonable steps to ensure that there is no public disclosure of confidential information (such as trade secrets or scientific secrets) and other commercially sensitive information' in any of the three levels of reporting.[538]

Work has not yet been completed to agree the procedures for filing and access by tax administrations to any of the three levels of documentation. Options under consideration apparently include direct filing to all administrations where there is a taxable presence, central filing with automatic access or sharing, filing with the parent's authority and sharing via information exchange, and technological solutions. Reaching agreement on these procedures is expected to be completed in early 2015.[539]

The formulation of a template for country-by-country reporting is a major achievement. We hope that the political commitment will continue to be strong enough to ensure effective implementation.[540]

The Synod agrees with the BEPS Monitoring Group that the Country-by-Country report should be regarded clearly as separate from transfer pricing documentation. It is very unfortunate that some, especially developing countries, experience such problems accessing information on related-party transactions that they consider that it should be included in the Country-by-Country report. This is no reason to confuse the two. Instead, there should be a strengthening of the requirements for transfer pricing documentation, especially the Master File, and particularly of the mechanisms for access by tax authorities. We hope that this can be done, and that it will result in full consensus on the Country-by-Country report template, to provide a general overview of every MNE's worldwide presence.[541]

The OECD report still leaves open the key issue of access. In view of the very general nature of the information required by the Country-by-Country report template, there seems no valid reason why these reports should not be published. The report rightly stresses the need for tax authorities to preserve strict confidentiality of information which may be commercially confidential. However, the Country-by-Country report as now designed would not normally

[536] BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, p. 12.
[537] BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, p. 12.
[538] BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, p. 12.
[539] BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, p. 12.
[540] BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, p. 12.
[541] BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, p. 12-13.

include such information. Publication should therefore be the norm, subject perhaps to allowance for exceptional cases. There is widespread public interest in such greater corporate transparency, which has led to mandatory publication requirements especially in the EU and the US of such reports in specific sectors (extractive industries and financial services). Finally, this data would constitute an invaluable information resource, which should be treated as public domain. At present, corporate data, even if it originates from state legal requirements, for example for publication of company accounts, are in practice extremely difficult to access. Hence, both researchers and even government bodies such as tax authorities, are dependent on private providers of data-bases. This is particularly damaging to developing countries, both because of the high cost of subscriptions, and because the coverage of developing countries in such databases is poor. The G20 should take a lead in making this important standard a worldwide expectation, and ensure that the data is publically available to support corporate transparency and facilitate tax enforcement everywhere in the world.[542]

At the same time, tax authorities continue to have an important need for easy access to the information that would be required in the Master File. We hope that the OECD can devise an efficient solution for automatic transmission to every tax authority in which a MNE has a taxable presence. It would be highly unsatisfactory if they had to rely on obtaining this important data through the vagaries of information exchange, which would be time-consuming, and potentially discriminatory. Attention should also be given to improving the mechanisms for a tax authority to easily obtain on request the Local File supplied to another country where it has a demonstrable need.[543]

Action 15: Develop a Multilateral Instrument

International tax rules are embodied in treaties, almost all bilateral. If a revision to the text of model treaties is agreed (by the OECD or the UN) it can take years for existing bilateral treaties to be renegotiated. In addition, treaty coverage is variable, and many developing countries have few treaties. Changes to the interpretation of existing treaty articles can be implemented more quickly, by amending the Commentary to the model treaty, or by amending other documents especially the Transfer Pricing Guidelines. However, these have only indirect legal effect, although they strongly influence administrative practices, they cannot change the binding legal provisions. In addition, variations in the texts of actual bilateral treaties, of which there are around 3,500 in force, mean that the system is incoherent and full of loopholes.[544]

A multilateral convention could deal with many of these problems, by enabling changes to be implemented more quickly and in a coherent and coordinated manner. However, it poses a number of legal questions, such as whether and to what extent it could override existing treaties, which states would be involved in negotiating the text and eligible to join, and whether states could pick and choose which provisions to accept or would need to sign up to at least a core package of provisions. Negotiation of such a convention could take some time, presumably starting in 2017 once the OECD project is expected to complete, and even after a text is agreed it would not be binding on any state until it ratifies the convention.[545]

The OECD report cogently explains the reasons why a multilateral convention is desirable, as well as how it would be feasible. It proposes an instrument that would co-exist with the existing network of bilateral treaties, to both modify and add new provisions to them. Such an instrument would apply only where states accepting it already have a bilateral treaty between them. However, the OECD report leaves open the question of whether a dispute-settlement

[542] BEPS Monitoring Group, ‘OECD BEPS Scorecard’, October 2014, p. 13.
[543] BEPS Monitoring Group, ‘OECD BEPS Scorecard’, October 2014, p. 13.
[544] BEPS Monitoring Group, ‘OECD BEPS Scorecard’, October 2014, p. 13.
[545] BEPS Monitoring Group, ‘OECD BEPS Scorecard’, October 2014, pp. 13-14.

provision could be included which might apply even in the absence of a bilateral treaty. The relationship between such a multilateral instrument and any bilateral treaties concluded subsequently by states is an important issue, which the OECD report states should be decided at the political level. It also identifies a number of other technical issues which it says can be resolved through appropriate drafting, including the use of compatibility clauses and suitable superseding language. Further, it suggests that the scope of such a convention could be expanded subsequently, so providing a method for regular systematic updating of the treaty system.[546]

Two important questions remain. One is the content of the instrument. The report discusses which potential treaty provisions might be considered to be `multilateral in nature' and those which are rather bilateral and for which `flexibility can be provided within certain boundaries'. However, it does not clearly explain whether the intention is that the `multilateral in nature' provisions would also be combined into a core package, requiring acceding states to accept them all. This is particularly important because among the provisions suggested for this group is a multilateral dispute-settlement procedure which would include an arbitration provision `to provide certainty and resolution of disputes'. The second concerns the arrangements for negotiation. It stresses the importance of broad participation, and envisages a call by the G20 for international conference with a mandate limited in time, as well as scope (to implementing the BEPS Action Plan).[547]

The BEPS project offers an unprecedented opportunity to bring coherence and great coordination to international tax rules. To achieve this, a multilateral convention is indeed essential. To succeed, however, would require ensuring that the content of such a convention is both effective and widely acceptable. The BEPS project is hampered because although the G20 includes the world's most powerful states, it excludes the poorest and most needy, who are also relatively more dependent on corporate tax revenues. It is clearly right that all states should be entitled to participate in the negotiation of any multilateral treaty. Nevertheless, by the nature of the process, much of the content of such a treaty would already have been determined.[548]

This may be unavoidable, and hence be acceptable up to a point. However, the key issue to be addressed is to what extent this would be considered a package deal, and if so which provisions would be part of such a package and which might be optional. In this respect, a key question is the dispute settlement procedure, especially if it might involve binding arbitration. This is known to be a red line issue for many governments, especially developing countries. The Synod shares two particular concerns with the BEPS Monitoring Group. One is that the BEPS project may well result in a highly complex set of rules lacking coherence and likely to generate conflict. This indeed is what leads many to press for a binding arbitration procedure. However, such a procedure is an inappropriate way to attempt to resolve conflicts due to rules which are not themselves clear and susceptible to different interpretation. Secondly, the present tax dispute settlement procedures are highly secretive and hence lack legitimacy. Any strengthening of these procedures should in the first instance consider how they could be made far more transparent.[549]

34.4.7. Disclosure of Ultimate Beneficial Owner

The OECD has provided data on the use of special purpose entities (SPEs) through jurisdictions that have assisted in profit shifting by multinational companies. In general terms, SPEs are entities with no or few employees, little or no physical presence in the host economy, whose assets and liabilities represent investments in or from other countries, and

[546] BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, p. 14.
[547] BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, p. 14.
[548] BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, p. 14.
[549] BEPS Monitoring Group, 'OECD BEPS Scorecard', October 2014, pp. 14-15.

whose core business consists of group financing or holding activities.[550] The Synod of Victoria and Tasmania is concerned about the prevalence of SPEs in structures that use transfer mispricing to shift profits to secrecy jurisdictions. This is made worse when the owners of the SPE cannot be readily identified.

The Synod seeks that Australia introduce a requirement for a public register of the ultimate beneficial owners of companies, given the role shell companies and special purpose entities play in both tax dodging and many forms of illicit flows.[551] It should also support this becoming a global standard. Research by Findley, Nielson and Sharman also found Australian corporate service providers were near the top of corporate service providers in terms of being willing to set up an untraceable shell company even when there was significant risk the company in question would be used for illicit purposes.[552]

The ATO has publicly stated "Over a hundred Australians have already been identified involving tens of millions of dollars in suspected tax evasion through the use of 'shell companies' and 'trusts' around the world." In October 2013, the Australian Federal Police charged three men with tax and money laundering offences involving $30 million. It is alleged they used a complicated network of offshore companies to conduct business in Australia while hiding the profits offshore, untaxed. The profits were then transferred back to Australian companies controlled by the offenders and disguised as loans so the interest could be claimed as a tax deduction. The level of alleged criminal benefit was estimated at $4.9 million.

A public register of the ultimate beneficial owners of companies would be a significant step in addressing the risks raised by opacity of shell companies.

The G20 Leaders' Summit in Brisbane in November 2014 took a small step forward in disclosure of beneficial ownership by committing to implement the G20 High Level Principles on Beneficial Ownership Transparency.[553]

34.4.8 Private Sector Whistleblower Reward and Protection

Whistleblowers in the private sector in other jurisdictions have played a valuable role in exposing cases of tax evasion (and other fraud against government). The OECD Working Group on Bribery *Phase 3 Report on Implementing the OECD Anti-Bribery Convention in Australia* released in October 2012 found Australia provided inadequate protection to whistleblowers in the private sector:

> *144. Regarding private sector whistleblowers, laws cited by the Australian authorities are insufficient or irrelevant to foreign bribery. Section 317A of the Corporations Act protects officers, employees and contractors of Australian companies who disclose violations of the Corporations Act to ASIC. This covers disclosure of foreign bribery-related false accounting, but not foreign bribery per se. Whistleblower laws that apply only to financial institutions are not so restricted and cover disclosures about any misconduct, including foreign bribery. None of these laws, however, protects disclosures to law enforcement or the media….*

[550] OECD, 'Addressing Base Erosion and Profit Shifting', OECD Publishing, http://dx.doi.org/10.1787/9789264192744-en, 2013, p. 18.
[551] Global Witness, 'Undue Diligence. How banks do business with corrupt regimes', March 2009, pp. 109-111.
[552] Michael Findley, Daniel Nielson and Jason Sharman, 'Global Shell Games: Testing Money Launderers' and Terrorist Financiers' Access to Shell Companies', Centre for Governance and Public Policy, Griffith University, 2012, p. 21.
[553] G20 Leaders' Communique, Brisbane Summit, 15-16 November 2014, p. 3.

The Working Group highlighted the value of whistleblower protection in combating foreign bribery, but this would be equally applicable to disclosures of tax evasion and tax avoidance:

> *145. Despite inadequate protection, some whistleblowing does occur. Some participants at the on-site visit believed that whistleblowing in the private sector has been useful in detecting misconduct such as foreign bribery. In the Securency/NPA case, one whistleblower reported wrongdoing to the company and the AFP, while a second disclosed allegations to the media. The case, however, may also highlight the need to better protect whistleblowers, as two Securency employees claim to have been dismissed after raising bribery concerns. Commentators believe that better whistleblower protection could lead to a higher level of foreign bribery enforcement.*

The OECD Working Group on Bribery recommended:

> … *Australia put in place appropriate additional measures to protect public and private sector employees who report suspected foreign bribery to competent authorities in good faith and on reasonable ground from discriminatory or disciplinary action.*

Since 1863 the US has also had the *False Claims Act* which has encouraged whistleblowers to come forward with information about fraud against the government in return for a share of the damages recovered. The *False Claims Act* empowers citizens to bring suit on behalf of the government for fraud against the government.[554] The Act rewards the whistleblower 15% to 25% of the fraud recovered due to the whistleblowing.[555]

The provision of financial reward for whistleblowing has allowed the US to expose major cases of illegal activity against the US Government. Between 1986 and 2008 the amount of recovery from fraud was more than US$20 billion, and fraud has been detected at 50 times the rate before the amendments to the *False Claims Act* were made in 1986.[556] Last year the US Internal Revenue Service paid former banker Bradley Birkenfeld US$104 million for his role in exposing the role Swiss bank UBS had played in US citizens engaging in tax evasion. According to the IRS, Birkenfeld had "provided information on taxpayer behaviour that the IRS had been unable to detect, provided exceptional cooperation, identified connections between parties to transactions, and the information led to substantial changes in UBS business practices and commitment to future compliance." They went on to say "While the IRS was aware of tax compliance issues related to secret bank accounts in Switzerland and elsewhere, the information provided by the whistleblower formed the basis for unprecedented actions against UBS." His information directly resulted in UBS having to pay a US$780 million fine to the US Government and over 35,000 taxpayers voluntarily repatriated their illegal offshore accounts. This resulted in the collection of over US$5 billion in back taxes, fines and penalties. His disclosure also indirectly lead to revised tax treaty negotiations between the US and Swiss governments, and to UBS subsequently releasing the names of over 4,900 US taxpayers with offshore accounts, who were then investigated.[557]

A 2007 study of corporate fraud in the US between 1996 and 2004 by Alexander Dyck, Adair Morse and Luigi Zingales found only 6% of frauds were uncovered by the SEC and 14% by auditors. By comparison 19% were exposed by employees and 14% by the media.[558]

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[554] Indira Carr, "The UK Bribery Act: Business Integrity and Whistleblowers", *Financial Fraud Law Report* 4(4), April 2012, pp. 368-369.
[555] Kim Sawyer, "Rewarding whistleblowers for risk brings results", *The Australian Financial Review,* 23 December 2008.
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Media sources have reported as part of the Stop International Tax Evasion Program by the Canadian Revenue Agency, whistleblowers will be rewarded up to 15% of federal tax collected for information leading to tax recoveries exceeding $100,000.[559] The rewards will only be paid where the questionable activity involves foreign property, or property located or transferred outside Canada, or transactions conducted partially or entirely outside Canada. However, reward payments will be subject to income tax.

Germany also provides rewards for whistleblowing on tax evasion.[560]

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Acknowledgement: The Justice and International Mission Unit would like to acknowledge the contribution of Professor Kerrie Sadiq, School of Accountancy, Queensland University of Technology to the transfer pricing section of this submission.

The Unit would also like to thank its research interns Mason McCann and Lauren Blackmore for their assistance with research for sections of the submission.

The Unit would further like to thank the ATO for the documents provided under FOI and the professional and timely way the FOI request was handled.

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