SPEED AND STRACEY LAWYERS

1 July 2015

General Manager
Law Design Practice
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sirs

BETTER TARGETING THE INCOME TAX TRANSPARENCY LAWS

Speed & Stracey Lawyers is a specialist taxation and commercial law firm in Sydney which services a range of private clients and their corporate groups.

We welcome the opportunity to participate in the Government's consultation in respect of the Exposure Draft *Tax and Superannuation Laws Amendment (Better Targeting the Income Tax Transparency Laws) Bill 2015* (Draft Bill) and fully support the amendments contained therein, for the reasons set out in the enclosed Submission.

Thank you for considering this Submission to the Draft Bill. Should you have any questions or wish to discuss our view further, please contact Daniel Appleby on (02) 8076 8242.

Yours sincerely
SPEED & STRACEY LAWYERS

Daniel Appleby
dappleby@sslaw.com.au

BETTER TARGETING THE INCOME TAX TRANSPARENCY LAWS
SPEED & STRACEY LAWYERS
SUBMISSION

1. Introduction

We believe that the current tax disclosure laws in section 3C of the *Taxation Administration Act 1953* (the Act), which were enacted by *Tax Laws Amendment (2013 Measures No.2) Act 2013,* are harsh, discriminatory and unjust against certain company taxpayers whose gross accounting income exceeds $100 million in any income year.

Speed & Stracey Lawyers recognises that the amendments to the Draft Bill are designed to counter and reduce the adverse impacts of the current disclosure laws in respect of Australian private companies and we therefore support those amendments. Our reasons are set out in full in Section 2 below. We submit the Draft Bill should be passed as soon as possible, subject to clarification of a specific aspect of the drafting in the proposed new section 3C(1) of the Act.

Whilst it is submitted that the Draft Bill should be passed in order to protect Australian private companies from being subjected to these unfair and unjust laws, we submit that in the alternative, the current tax disclosure laws should altogether be repealed, for the reasons set out in Section 5 below.

2. In favour of the Draft Bill

We are in favour of the amendments to the Draft Bill and agree with the reasons set out in the explanatory memorandum (EM) accompanying the Draft Bill, as to why the amendments to section 3C of the Act are necessary.

The current disclosures have the potential to lead to unnecessary waste of resources of Australian private companies. This can adversely affect the competitive landscape and market conditions in which these companies operate in. As noted in the EM, the information to be disclosed may not otherwise be available to the private company's competition, customers and suppliers. This notion was emphasised in a recent Opinion editorial by the Assistant Treasurer the Honourable Josh Frydenberg MP when he stated an example of a company which sells to only one or two major customers and the disclosure of gross income could be used to work out that company's profit margins, putting it in a weaker position during price negotiations.[1] This is a very real and commercial risk which have been expressed by numerous Australian businesses in the community.

Resources would also be wasted in private companies attempting to explain or justify their tax information to the public. Whilst the Government released the consultation paper *Administrative Arrangements for Reporting Entity Information* in March 2015, which discussed initiatives to minimise the scope for misinterpretation of the reported information, it is still a real concern amongst private company taxpayers that the options discussed in the consultation paper did not go far enough and such taxpayers would still be compelled to endeavour to

[1] *Why we need to wind back Gillard's damaging legislation on company tax disclosure*, Josh Frydenberg MP, The Australian 16/6/2015

explain their tax position. Doing so would require much cost and compliance in publishing additional information or explanations, as well as a public relations exercising in balancing the information that is required to be disclosed with any additional information disclosed by the taxpayer directly.

Having to dedicate resources to such a compliance task would not only impact on the financial and time management of an organisation, but may also present as a barrier to the business expanding for fear of exceeding the $100 million threshold. In this regard, such resources are misallocated and will have wider impact on the competitive environment of the market.

The potential for misallocation of resources is also demonstrated by the concern of companies restructuring their affairs in order to keep below the threshold – an issue highlighted in the EM to the Draft Bill. Private companies will likely operate in corporate structures that are less efficient simply in order to avoid the risk of disclosure of their tax information. We are aware of this concern or prospect being raised by private Australian companies.

Lastly, the EM raises the concern by taxpayers of personal privacy and security of the shareholders of private companies. We consider this risk should not be discounted, given that there is in our view likely to be a misguided public perception of the income and tax affairs of a private company equating to the income and tax position of the shareholders of that company. Concerns over security are not unfounded given that the EM noted the concerns raised in Japan where similar disclosure laws were repealed in 2005 because it was reported that the information was causing crimes and harassment. High profile taxpayers and business people, who are already under public scrutiny, would likely encounter further media exposure as a result of these disclosures being misinterpreted, and this would only result in greater risk to personal security and invasion of privacy. Many would encounter public attention for the first time – there are many private company groups who are not well known and do not appear on the "BRW Rich List", for example, but would be subjected to the public disclosure of their personal tax affairs under section 3C.

We submit that the reasons raised in the EM to the Draft Bill are relevant, cogent and justified in order to protect Australian private companies and their shareholders from the current, harsh disclosure laws.

3. Additional reasons for amendments to section 3C

In addition to the reasons raised in the EM and discussed in Section 2 above, we submit further reasons in support of the amendments in the Draft Bill, set out as follows.

3.1 Breach of the fundamental right to privacy of shareholders of private companies

Section 3C of the Act is a significant departure from the longstanding principle of a taxpayer's right to privacy of their tax affairs. Whilst the section limits it to taxpayer companies whose total income exceeds $100 million, there is a real risk that the fundamental right to privacy is breached in relation to the shareholders of

those affected private companies. This is because it is often perceived that the disclosure of the income and tax affairs of a private company is tantamount to the disclosure of the personal income and tax affairs of the owners of those businesses. The shareholders can usually easily be identified through a search of the ASIC registers which will in most cases reveal the individuals or family groups associated with a particular private company. This can be contrasted to public companies where details of shareholders are not so discernible and shareholdings are widely held or held by institutions and nominees.

Section 3C would seem to have unintended consequences of indirectly disclosing the broader income and tax affairs of the shareholders of private companies – giving rise to a fundamental breach of their right to tax privacy, which is not the policy intent of section 3C. By excluding private companies from section 3C, this would eliminate the risk of the owners of such businesses from being indirectly exposed to the disclosure laws.

3.2 Misinterpretation of information

Not only is there a real risk of breaching the fundamental right to tax privacy as discussed in section 3.1 above, but shareholders of these private companies would risk having their income and tax affairs misconstrued and misinterpreted as a result of incorrectly presuming that the income and tax position of the private company equates to that of the shareholders.

For example, an item of income may be exempt or 'non-assessable non-exempt' to the private company, however it will effectively be taxed as an unfranked dividend when ultimately distributed to the shareholders – this being at the individual's marginal tax rate without any franking credits. The public perception may be that the ultimate shareholder has derived tax-free income through its private company, but in reality, there is no loss of revenue to the Commissioner as tax would be paid when the profits are distributed to the shareholders.

The result is that individual and family group shareholders would be subject to media scrutiny as a result of laws which are designed to target companies only. The opportunity for misinterpretation of tax information is high given that by and large, the general public does not understanding the complexities of corporate and personal income taxation.

3.3 The tax disclosure laws are intended to target large multinationals

In a recent article in the Australian Financial Review, the Commissioner of Taxation Mr Chris Jordan was quoted as saying that the introduction of section 3C into the Taxation Administration Act "was really for multinational companies operating here, disclosing quite low revenue" and was not intended to capture Australian private companies. Whilst this statement is not directly reflected in the explanatory memorandum to the Draft Bill, it shares similar sentiments to the policy rationale of targeting "large corporate tax entities" and discouraging them from engaging in aggressive tax avoidance practices.

The current tax disclosure laws are overly broad and capture private companies that in substance should not be the target of such rules. We are not aware of any

evidence to suggest aggressive tax avoidance practices by Australian private companies. Furthermore, the notion that a company is "large" by virtue of it having total income of $100 million, is contrary to the Australian Taxation Office's (ATO) traditional classifications of "large multinational" taxpayers. According to the ATO, only entities that have total income above $250 million are considered "large" taxpayers. There does not appear to be any logical explanation as to why a threshold amount of $100 million was selected and would otherwise appear to be an arbitrary amount.

3.4 The disclosure laws are contrary to the rule of law

As discussed above, the current disclosure laws are discriminatory as it targets only certain taxpayers whose gross accounting income exceeds an arbitrary threshold amount. This is contrary to the fundamental principle of the rule of law whereby laws are meant to apply equally and without discrimination.

Moreover, as mentioned above, the affected taxpayers are burdened with additional costs in potentially having to justify their tax position to the public, restructure their corporate affairs in order to avoid the disclosure laws altogether – an unjust outcome given that it is a waste and misallocation of resources.

On this basis, we strongly support the amendments to the Draft Bill in protecting Australian private companies from these discriminatory and unjust disclosure laws, and believe it is a significant improvement to the provisions of the Act enacted in 2013.

4. Possible clarification to the drafting of section 3C

The proposed new section 3(C)(1) states that the disclosure rules will apply where:

> *(a) The entity has total income equal to or exceeding $100 million for the income year; and*
> *(b) One or more of the following applies:*
> *(i) The entity was not an Australian resident private company for the income year;*
> *(ii) The entity was a member of a wholly-owned group during the income year that has a foreign resident ultimate holding company;*
> *(iii) The **percentage of foreign shareholding in the entity** was greater than 50% at the end of the income year.* (emphasis added)

The term "percentage of foreign shareholding" (proposed section 3C(1)(b)(iii)) is not a defined term but rather, is determined by the Commissioner based on information disclosed in the company tax return and the definitions in the company tax return instructions.

The company tax return instructions are an administrative document that is subject to change and is not determined by Parliament. In the interests of clarity and certainty, we submit that the term "percentage of foreign shareholding" should be legislatively defined in the Taxation Administration Act for this purpose.

5. Alternative submission: Repealing section 3C

Whilst the amendments in the Draft Bill go some way to improve the current disclosure laws, it nonetheless continues to be discriminatory and unjust. As such, whilst the proposed amendments seek to protect certain Australian private companies from the disclosure requirements, we submit that in the interests of the rule of law and public policy, the laws should be repealed altogether for the reasons discussed below.

Firstly, it is difficult to see how the disclosure of select aspects of gross accounting income, net taxable income and Australian tax payable could generate meaningful public debate about tax policies. Such information, when presented without any context, could not reasonably act as a catalyst to explain any tax issues or policies. Instead, as discussed above, the information when presented in isolation, is misleading and has the propensity to be misinterpreted by the public, which is damaging to the reputations of the affected companies.

As many commentators have previously expressed, the result of the disclosures is a "naming and shaming" in the press. In fact, both the Treasury and the ATO have noted that comparison of accounting and net taxable income is fundamentally different, misleading and potentially dangerous because the laws lack detailed technical explanation on the differences between accounting and tax.

Secondly, as discussed above in section 3, the laws are discriminatory not just towards Australian private companies, but all companies that exceed the $100 million threshold. To apply those laws, and that level of public scrutiny, to only one type of taxpayer entity – companies, and not trusts, partnerships, individuals, or otherwise – and only to those which exceed a certain threshold, creates a disproportionate and discriminatory rule and is contrary to the rule of law.

We submit, in the alternative, that the current disclosure laws are "bad laws" and should therefore be repealed.