The Commonwealth Treasury

Implementing a Diverted Profits Tax

Submission

Oxfam Australia

July 2016

1. Introduction

Oxfam Australia welcomes this opportunity to provide a submission on implementing a Diverted Profits Tax (DPT). We also welcome the Australian Government's announcement in the 2016-17 budget that it will introduce a DPT to help ensure that entities operating in Australia cannot avoid Australian taxation by transferring profits, assets or risks offshore through related party transactions that lack economic substance.

Data released by the Australian Taxation Office (ATO) shows that over 1 in 3 companies with turnover above $100 million did not pay any tax in 2013-14. At a time when many multinational corporations are not paying their fair share of tax, Oxfam Australia believes that the DPT is a step in the right direction.

2. About Oxfam Australia

Oxfam Australia is an independent, not-for-profit, secular development agency whose vision is of a just world without poverty. Oxfam:

- undertakes long-term development programs,
- provides emergency response during disaster and conflict,
- undertakes research, advocacy and campaigning to advance the rights of poor and vulnerable people, and
- promotes fair trade, supporting local artisans and producers through our shops and Fairtrade food brand.

In 2014-15, Oxfam worked with partner organisations in 85 countries around the world, including indigenous Australia, to improve the lives of 25 million people. Of that number, Oxfam Australia directly reached more than 5 million people — 2.3 million people through our 106 long-term development and advocacy projects with the help of 525 partner organisations; and, in partnership with Oxfam affiliates, almost 3 million people who were affected by disaster or conflict.

Oxfam Australia has more than 500,000 supporters in Australia who contribute skills, time and financial support to advance our work. We are a member of Oxfam International, a global confederation of 18 organisations that work together, investing more than $1 billion a year to overcome poverty, inequality and injustice in more than 85 countries around the world.

Recent research by Oxfam showed that in 2015, the richest 62 individuals in the world owned more wealth than the poorest 50% of people combined[1]. At a time when inequality is increasing around the world, fiscal policy, and in particular taxation can have a huge impact on the fight against poverty. As shown in Oxfam Australia's recent report *The Hidden Billions*[2], we estimate that in 2014 tax minimising Australian-based multinationals deprived Australia of AUD $6 billion in tax revenue, and also deprived developing countries of AUD $3 billion in vital public funds. With inequality worsening around the world, making the fight against poverty even harder, companies must pay their fair share of taxes, so that the revenue can be used to improve people's lives, both here and for the world's poorest peoples.

3. Tax payers subject to the DPT

The current proposal indicates that the DPT will apply to significant global entities operating in Australia. In line with the December 2015 Multinational Tax Avoidance legislation, a global entity is defined as an entity or group of entities with annual global income of $1 billion or more.

Oxfam Australia believes that this threshold of global income is too high for the purposes of the DPT, and needs to be lowered to $250 million in line with the ATO definition of large business[3]. The current definition would preclude many large multinationals operating in Australia.

Oxfam Australia supports the *de minimis* threshold of $25 million designed to preclude entities that do not pose a significant compliance risk. However, we note that this threshold is on the high-side.

[1] Oxfam International, "An economy for the 1%", *Oxfam Briefing Paper,* January 2016.

[2] Jamaldeen, M., (2016), The Hidden Billions, Oxfam: Melbourne.
Retrieved from https://www.oxfam.org.au/wp-content/uploads/2016/06/OXF003-Tax-Havens-Report-FA2-WEB.pdf:

[3] ATO. (2016). *Large business.* Retrieved from https://www.ato.gov.au/business/large-business/

4. The effective tax mismatch requirement

In addition to the scope requirements, there are two tests required for the DPT to be activated:

- The transaction has given rise to an effective tax mismatch; and
- The transaction has insufficient economic substance.

The current proposal imposes a penalty tax rate of 40 percent on profits transferred offshore through related party transactions with insufficient economic substance that reduce the tax paid on the profits generated in Australia by more than 20 percent.

Oxfam Australia believes that the 20 percent effective tax mismatch threshold is too high, and would allow large multinational companies to keep shifting profits up to this threshold.

In the table below we have produced two simulations (assuming a 15% rate of return on turnover[4]) that show the tax loss due to two multinational corporations (above the *de minimis* threshold) claiming deductions that reduce their Australian tax liability by less than 20%.

These simulations are based on a scenario where a company claims deductions that reduce tax payable in Australia by 18%. A large multinational with Australian turnover of $ 2 billion, for example, will be able to avoid paying over $16 million in tax in Australia since the DPT will not come into play. A smaller multinational, with Australian turnover of $ 750 million will be able to avoid paying over $6 million in tax to the ATO.

	Companies with turnover above $1 bn	Companies with turnover below $1 bn
Total annual Australian turnover	$2,000,000,000	$750,000,000
Estimated (15%) profit before deductions	$300,000,000	$112,500,000
Total actual tax due in Australia	$90,000,000	$33,750,000
Offshore deductions claimed (18%)	$16,200,000	$6,075,000
Total tax paid in Australia after deductions	$73,800,000	$27,675,000
Tax loss to Australia circumventing DPT	**$16,200,000**	**$6,075,000**
Percent reduction in the Australian tax liability	**18%**	**18%**

Notes: these simulations are based on an assumed rate of return of 15%.

[4] This is based on analysis of 2013-14 ATO data on turnover and tax payable, which lists public and foreign entities (including foreign private companies) with total income of $100 million or more.

Our analysis of ATO data (from 2013-14) shows that there are 290 public and foreign entities (including foreign private companies) with Australian turnover above $1 billion, and 1248 entities with turnover between $100 million and $ 1 billion. Though not every company would be returning an accounting profit in any given financial year, as shown in the table above, the proposed effective tax mismatch threshold gives large multinationals sufficient room to keep shifting profits. The result of this is that Australia is likely to continue losing millions even with a DPT in place.

5. Recommendations

In response to the issues identified in this submission, Oxfam Australia proposes three key recommendations:

Recommendation 1: lower the global entity threshold to $250 million in line with the ATO definition of large business

Our analysis of ATO data (from 2013-14) shows that there are 561 public and foreign entities (including foreign private companies) with turnover between $250 million and $1 billion. Expanding the coverage of the DPT to these entities will further prevent base erosion.

Recommendation 2: set the effective tax mismatch threshold to 10%.

Oxfam Australia recommends that the effective tax mismatch threshold be reduced to 10%. In the simulation above, the tax loss to Australia would be halved to over $8 million and over $3 million respectively. The 'sufficient economic substance' test will ensure that genuine transactions are not subjected to the DPT.

Recommendation 3: determine the effective tax mismatch using both an *ad valorem* threshold of 10%, and a fixed-unit threshold of $5 million, whichever is lower

Oxfam Australia recommends that the effective tax mismatch be determined as the lower of a 10% threshold and a fixed-unit threshold of $5 million. This mechanism would prevent more profitable multinational corporations from shifting profits overseas, since the $5 million would act as a minimum threshold level required to activate the DPT.

For example, a company with Australian turnover of $1 billion, operating with a rate of return of 20 percent (profit of $ 200 million), can claim deductions up to under $6 million (using the 10% threshold). However, since $6 million is above the designated fixed-unit threshold of $5 million, the DPT can now be activated even though the deduction would be less than 10%.

Oxfam Australia also strongly recommends that the fixed-unit threshold should, ultimately, be determined by the regulatory cost to the ATO. We believe that $5 million is a reasonable threshold that is likely to be well above the regulatory average cost (per assessment) to the ATO. Ultimately, the DPT needs to be designed such that the revenue raised outweighs the regulatory cost to the ATO. The *de minimis* threshold would also prevent any additional compliance burden on business.

Oxfam Australia would also like to acknowledge and support the submission made by the Tax Justice Network Australia (TJN-AUS) that covers a range of additional considerations pertaining to the proposed DPT.

In particular, both Oxfam Australia and TJN-AUS do not agree that the amount of debt, a significant global entity has in Australia, should be exempted from the DPT if it falls within the thin capitalisation ‘safe harbour’. We argue that any debt amount that gives rise to an effective tax mismatch, and which has insufficient economic substance should be subject to the DPT.

The only effective way to end many of the tax minimisation strategies of multinational enterprises is to ensure that taxes are paid where economic activity and value is created. Though the DPT is a step in the right direction, the issues identified in this Oxfam Australia submission need to be addressed if the DPT is to become truly effective.

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