Manager
Small Business Entities and Industry Concessions Unit
Individuals and Indirect Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

13 January 2017

Dear Sir/Madam,

SUBMISSION - INCREASING ADMINISTRATIVE PENALTIES FOR SIGNIFICANT GLOBAL ENTITIES

We appreciate the opportunity to participate in the Treasury consultation process in relation to increasing administrative penalties for significant global entities (SGEs) described in the Exposure Draft (ED) legislation and accompanying Explanatory Memorandum (EM) released for comment on 20 December 2016.

The Government's policy regarding administrative penalties was expressed in the 2016-17 Budget as intending to strengthen the integrity of Australia's tax system by increasing administrative penalties imposed on companies with global income of $1 billion or more who fail to adhere to tax disclosure obligations.

The policy announced by the Government seemed designed to address a risk that SGEs may prefer to pay a nominal fine rather than bear the burden of compliance with increased reporting and disclosure obligations. We accept that the administrative penalty regime as it currently stands could be improved in this regard. We note in particular the policy statement that "penalties relating to the lodgement of tax documents to the Australian Taxation Office (ATO) will be increased by a factor of 100."

The Government's announcement is clearly intended to be deliberately severe. By way of example, in relation to penalty regimes applying to Country-by-country reporting, we note that by our assessment across the countries for which data is available, the Government's announcement would result in Australia's starting penalty being three times higher than the highest starting penalty in any other country, and about nine times higher than the average starting penalty. Australia's maximum penalty would be one of the highest (if not the highest) of all countries, and about five times higher than the average.

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Keeping this aspect of the Government's objective in mind, we note in our submission several circumstances where further detail and clarification would be welcome to mitigate unintended consequences. In particular, we recommend changes which should ensure that the administrative penalty which would apply to some entities is not inappropriately increased by a factor higher than the Government announced.

We have set out in **Appendix A** and **Appendix B** a number of substantive areas where we believe additional clarification will be important for not only taxpayers but to allow the Australian Taxation Office (ATO) to administer the new penalty rules.

If you have any questions please contact in first instance Peter Collins on 0438624700 or Greg Weickhardt on 0428769169.

Yours sincerely

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Appendix A - 'Failure to lodge' (FTL) penalties

1. Consistency with policy announcement

In certain instances the ED imposes a FTL administrative penalty more onerous than appears to have been the Government's policy intention. The Government's 2016-17 Budget announcement was that penalties "relating to the lodgement of tax documents to the Australian Taxation Office (ATO) will be increased by a factor of 100. This will raise the maximum penalty from $4,500 to $450,000, which will help to ensure that multinational companies do not opt out of their reporting obligations."[1]

We note that the FTL administrative penalty amount under the current law is worked out in part based on threshold attributes of the Australian taxpayer, not the global group of which it may be a member.[2] On the other hand, as acknowledged by the EM [1.22], a SGE can be an Australian entity which is part of a group with annual global income of AUD$1 billion or more. The mere fact that an entity is an SGE says nothing about its Australian attributes.

Thus, for example if under the current law a Medium entity meets threshold criteria in subsection 286-80(3) and happens to also be a SGE, then under the ED this entity will face a threat of FTL penalties increased by a factor of 250, not 100.[3]

It would seem to us that the Government's policy objective could still be met in a manner faithful to the 2016-17 Budget announcement if a sliding scale was instead adopted whereby the FTL Multiplier increased based on revenue thresholds of the Australian taxpayer, to a maximum of 500. This would have the advantage of eliminating the administrative penalty cliff inherent in the ED.

We think it is a reasonable community expectation that smaller entities necessarily have less administrative oversight and capabilities, a principle which both the current law and the ATO recognise. The volume of disclosure documents required by all SGEs has increased dramatically as a result of legislated and administration changes in recent years and is expected to increase again as a result of legislative changes announced but not yet enacted. For example, the proposal to introduce the Australian DPT from 1 July 2017, and anti-hybrid legislation (applying to hybrid payments on or after the later of 1 January 2018 or six months after the relevant law is enacted) will both require Australian public officers to understand the foreign tax treatment of cross-border transactions involving non-Australian MNE group members - whether the non-Australian member is directly a counterparty or involved indirectly within a series of transactions - if they are to demonstrate why these laws should not apply to their organisations.

In simple terms, under the current ED the same severe administrative penalties are applied to all SGEs regardless of the size of the entities in Australia, without regard to the fact that they may not be multinational enterprises at all (for example, many superannuation funds and universities are SGEs)

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[1] 2016-17 Budget Paper No 2External Link - Revenue Measures page 34

[2] s286-80 Taxation Administration Act 1953

[3] For example, under s286-80(3) for a Medium entity the base penalty amount is multiplied by 2. Under ED s286-80(4A), if the Medium entity is a SGE, the base penalty amount is multiplied by 500, an increase of a factor of 250.

and without regard to the fact that keeping abreast of the many complex Australian law changes applying to SGEs is easier for larger firms.

Further, there is a greater need for more guidance from the Commissioner on the remission of penalties if the penalty rates are to be so high. The excessiveness of the penalty increase puts the Commissioner under more pressure to remit penalties in cases where there is a need to reduce the rate of penalty to be commensurate with the culpability of the taxpayer, than if the penalties had a more reasonable ceiling. This argument was accepted by the Parliament in the amendment of the penalty rules back in the early 1990s - previously 200% penalties could apply but the ATO rarely imposed them, almost always remitting them at the discretion of the Commissioner. To reduce compliance costs for the ATO and taxpayers and promote certainty, the penalty levels were reduced to today's levels.

2. Commonwealth penalty unit - increase in value

Table 1.3 of the EM sets out the FTL penalties that will apply to various entities under the proposed ED. It would be helpful if the final EM updated Table 1.3 to reflect the change in Commonwealth penalty unit value (increase from $180 to $210, with effect from 1 July 2017) announced in the Government's 2016-17 Mid-Year Economic and Fiscal Outlook (MYEFO) announcement.

3. 28 day periods

Under the current law (and ATO administration set out in Practice Statement Law Administration 2011/19) the base penalty amount is determined to be one penalty unit for every 28 days (or part thereof) that the taxation document is late.

As a result, the same penalty is imposed for taxation documents that are up to 28 days late, regardless of whether they are one day late or 28 days late. Thus, under current administration, once a document is late, there does not appear to be any additional incentive for a taxpayer to provide the document more promptly until it becomes more than 28 days late.

Under the ED, the penalty amounts for SGEs in these circumstances will increase to $105,000 per 28 day period.[4] Given the significant increase in value of the administrative penalty it does not seem equitable that a tax document which is one day late should attract the same significant financial penalty as a document which is up to four weeks late.

Under the current law, the application of uniform penalties in 28 day periods (or parts thereof) is - whist anomalous from an incentive perspective - practical given the relatively low dollar values of the penalties imposed. However given the increase in penalties proposed by the ED we recommend that this approach is now reconsidered. For example, the law and PS LA 2011/19 could be amended to stipulate that the base penalty amount for SGEs is determined to be 125 penalty units for each seven day period (or part thereof) that the taxation document is late. Alternatively a different progression could be considered which might better influence behaviours; for example imposing a growing penalty in each sequential seven day block (to the maximum of 500 penalty units for a cumulative 28 day

[4] Taking into account the increase in Commonwealth penalty unit value $180 to $210, with effect from 1 July 2017, with multiplier of 500 per ED s286-80(4).

period) during which the taxation document remained late. This would minimise the penalty on lodgements which narrowly miss the due date whilst shifting the burden of higher penalties to recalcitrant taxpayers.

4. Penalty per tax document

The ED proposes that the FTL administrative penalty (per the existing law) is imposed for each tax document which is not lodged. The ED (paragraph 1.20) specifically notes Country-by-country reporting tax documents required by Subdivision 815-E (ITAA 1997) are considered to be tax documents.

In this context, SGEs with foreign parents are necessarily dependent (by virtue of the content required) on foreign members of their group for preparation of the master file and preparation and lodgement of the country-by-country report. This means that a SGE which is a subsidiary of a multinational group can potentially be penalised twice for failing to lodge a master file and country-by-country report on time when both documents may be largely out of its control. In fact under current ATO administration the potential exists for a SGE to be penalised more than twice: PS LA 2011/19 paragraph 5 suggests that where multiple entities are required to be reported on the one document, multiple FTL penalties, equivalent to the number of obligations not lodged can be applied. This is particularly a problem for SGEs where there might be multiple Australian entities reliant upon foreign members of the group to provide them with the master file to lodge, for instance, or where multiple Australia entities are required to be disclosed in the Country-by-country Report (Table 2).

We acknowledge PS LA 2011/19 paragraph 10 which indicates that remission of FTL penalties by the Commissioner would "ordinarily be appropriate" when a taxpayer *"could not lodge as they had not received information from other parties such as employers (a payment summary for example) that would enable them to lodge. Ideally, the taxpayer should be able to demonstrate they have persistently tried to get this information."* Given the significant increase in FTL penalties proposed by the ED, we recommend that specific guidance pertaining to when FTL penalties will apply to country-by-country reporting documents be included in the final legislation, or at a minimum, the EM. For example, to what lengths must taxpayers be able to demonstrate they have persistently tried to obtain information?

In this regard we draw Treasury's attention to paragraph 42 of Chapter V of the report Guidance on Transfer Pricing Documentation and Country-by-country Reporting of the Organisation for Economic Cooperation and Development and the G20 (the BEPS Action 13 2015 Final Report) cited by Subdivision 815-E which reads:

"Care should be taken not to impose a documentation-related penalty on a taxpayer for failing to submit data to which the MNE group did not have access."

We also draw attention to Section 252(1)(f) of the Income Tax Assessment Act 1936 which provides that in the case of default in relation to complying with certain obligations such as the furnishing of information, the public officer will be liable to the same penalty as would otherwise apply to the company, and section 253 which can also bring a director, secretary or other officer of the company into the same regime.

It seems manifestly unfair, wholly inappropriate and not in keeping with the OECD's recommendation, nor indeed the Government's policy announcement (which was targeted at 'multinational companies', not their officers) that Australia would seek to pass a law which could apply severe financial penalties to individuals holding these roles when they may have no ability to provide the required documents. We submit that a safeguard should be written into the statute (not merely within ATO administrative guidance) to prevent this situation.

5. Safeguard from potential failures in exchange of information mechanisms

Country-by-country reporting data for Australian SGEs is to be exchanged government-to-government internationally via Exchange of Information (EoI) agreements within Australia's network of international tax treaties, tax conventions and tax information exchange agreements (TIEAs) with over 100 jurisdictions worldwide.

We submit that there should be safeguard mechanisms written into the final FTL administrative penalty statute which are specific to the country-by-country reporting obligations set out in Subdivision 815-E. These safeguards should specify that there should be no FTL penalty because of a failure in the EoI mechanisms to obtain country-by-country reporting documents. This should provide a safeguard, for example, where an Australian SGE makes a statement that it has complied with the requirements of Subdivision 815-E (and the ATO's administration thereof) because of a belief that its global foreign has filed the country-by-country report with a foreign country under which Australia has a EoI agreement.

We note that several of the jurisdictions with which Australia has EoI agreements, like the United States, have made public comments that they would suspend EoI with countries which used country-by-country reporting documents for more than just risk characterisation. Where a suspension of EoI occurs, an Australian SGE should not be penalised with a FTL administrative penalty.
In addition, it presumably may take some months before Australian's EoI treaty partners confirm whether a country-by-country reporting document has been lodged. This elapsed time should not be factored into the period used to compute a FTL administrative penalty imposed on a SGE.

6. Considerations for taxpayers that are SGEs because the Commissioner issues a notice under s960-555(3)

Under s960-555(3), the Commissioner is able to make a determination that an entity is a significant global entity in situations where:

1. The global parent entity of a group has not prepared global financial statements; and
2. The Commissioner reasonably believes that, if such statements had been prepared, the entity's annual global income would have been $1 billion or more.

This provision applies only where the Commissioner makes a determination; ie, there is no requirement for a taxpayer to self-assess whether they are an SGE if global financial statements are unavailable.

In situations where the Commissioner makes a determination under s960-555(3) and issues a notice to a taxpayer giving effect to that determination, the taxpayer(s) impacted by that notice will face additional reporting obligations, eg the Country-by-Country report, master file and local file, and general purpose financial statements, that they were not required to complete immediately prior to the

Commissioner issuing the notice. Taxpayers who are issued such a notice should be provided a reasonable timeframe to comply with the additional obligations, especially if the Commissioner issues the notice close to, or after, the statutory due date for any of the relevant reporting requirements.

The explanatory materials and/or ATO guidance should make it clear that no penalties for failing to comply with SGE reporting obligations can be applied to taxpayers who receive a notice under s960-555(3) for any period prior to the Commissioner issuing the notice. This is because the reporting obligations do not arise for that entity until after the notice is issued by the Commissioner. Further, the law (or, at a minimum, the EM and ATO guidance) should stipulate a reasonable time period that will be provided to taxpayers to comply with the additional reporting obligations they will face as a result of the Commissioner's determination. We submit that this period should not be less than six months.

7. Taxpayers who, in good faith conclude that they are not SGEs

Similar to the point above, where a taxpayer makes reasonable efforts to assess whether they are an SGE, and based on the information available to the taxpayer, concludes that they are not an SGE, that taxpayer should not be exposed to penalties for failing to comply with additional SGE reporting obligations if new information later becomes available which indicates that it is an SGE. In this situation, the Commissioner should be able to exercise discretion to remit penalties and to provide additional time for the taxpayer to comply with the additional reporting obligations.

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Appendix B - Penalties for making false or misleading statements

1. Confirm application of penalties pertaining to country-by-country reporting documents

We recommend that the final legislation (or EM) categorically clarify whether Country-by-country reporting documents can lead to a false or misleading statement conclusion and consequently be liable to penalties. We address each aspect of these penalties below.

a) Shortfall amounts and tax-related liabilities

Since the statute (Subdivision 815-E) requires SGEs to provide the Commissioner with tax documents (as defined for the purposes of s286-80(4) in the ED), we submit that it is reasonable to expect the statute (not just updated ATO administrative guidance) to confirm that for the purposes of s284-75 that country-by-country reporting documents:

i) Do not constitute statements which result in a shortfall amount; and
ii) Do not constitute documents necessary to determine a tax-related liability.

By extension, country-by-country reporting documents should not be considered for the purposes of establishing whether a taxpayer has a reasonably arguable position. Support for this submission can be found within paragraph 25 of Chapter V of the report Guidance on Transfer Pricing Documentation and Country-by-country Reporting of the Organisation for Economic Cooperation and Development and the G20 (the BEPS Action 13 2015 Final Report) which is cited by Subdivision 815-E, and reads [emphasis added]:

> *"The Country-by-Country Report will be helpful for **high-level transfer pricing risk assessment purposes**. It may also be used by tax administrations in evaluating other BEPS related risks and where appropriate for economic and statistical analysis. However, the information in the Country-by-Country Report **should not be used as a substitute for a detailed transfer pricing analysis** of individual transactions and prices based on a full functional analysis and a full comparability analysis. The information in the Country-by-Country Report on its own **does not constitute conclusive evidence that transfer prices are or are not appropriate**. It should not be used by tax administrations to propose transfer pricing adjustments based on a global formulary apportionment of income."*

In addition, Australia already incorporates principles in Subdivision 284-E governing what constitutes a reasonably arguable position for transfer pricing documentation. In our assessment, Subdivision 284-E is already fully consistent with paragraph 43 of the BEPS Action 13 2015 Final Report which reads:

> *"Another way for countries to encourage taxpayers to fulfil transfer pricing documentation requirements is by designing compliance incentives such as penalty protection or a shift in the burden of proof. Where the documentation*

meets the requirements and is timely submitted, the taxpayer could be exempted from tax penalties or subject to a lower penalty rate if a transfer pricing adjustment is made and sustained, notwithstanding the provision of documentation. In some jurisdictions where the taxpayer bears the burden of proof regarding transfer pricing matters, a shift of the burden of proof to the tax administration's side where adequate documentation is provided on a timely basis offers another measure that could be used to create an incentive for transfer pricing documentation compliance."

Australian transfer pricing documentation which meets the requirements of s284-E is required to be prepared by the time of lodgement of the income tax return. It is not required to be submitted to the ATO, but this is by the Commissioner's choice as this could have been required by the Commissioner under Subdivision 815-E. Therefore, since Australia already has a comprehensive penalty regime for application of penalties based on transfer pricing documentation and in light of the above arguments, we submit that the final legislation should stipulate that country-by-country reporting documents required by Subdivision 815-E should not result in shortfall amounts, nor be considered for the purposes of a reasonably arguable position, nor be considered necessary to determine tax-related liabilities.

b. Reasonable care

Even in the event that the final legislation (or EM) appropriately specifies that country-by-country reporting documents do not result in shortfall amounts or tax-related liabilities, we submit that guidance is required in the final legislation (or the EM) - given the proposed severe increase in penalties - as to what constitutes 'reasonable care' for the preparation of these documents.

For example, country-by-country report disclosures permit different approaches between taxpayers. Some taxpayers may choose to report data for a jurisdiction on an in-country consolidated basis (eliminating domestic related party transactions) whilst other taxpayers may choose to report as an aggregation of the data for each individual entity within the jurisdiction.[5] Will a taxpayer have demonstrated 'reasonable care' if some data for a jurisdiction are consolidated whilst others are aggregated?

Similarly, it is not clear whether a master file which is say merely two pages long but which purports to address each of the specified contents would be judged to have been prepared in 'intentional disregard' or 'recklessness'. There is simply no standard which has been made available for taxpayers (or tax agents) to make a reasonable conclusion about how the ED would apply in that regard. This is now especially important given that SGEs under the ED will face a threat of significantly higher penalties.

Further express clarification should also be provided on what circumstances disclosures in the Reportable Tax Position (RTP) schedules. The complexities in filing RTP schedules and assessing what transactions need to be disclosed are already incredibly burdensome for taxpayers, regardless of their sophistication. Error rates are high, even in circumstances where a taxpayer intends to fully

[5] See page 4, question 2.9 in ATO document 'Country-by-country reporting' Questions and Answers' released on 25 November 2016.

disclose a position, and this will only be exacerbated as significantly more 'everyday' scenarios, such as offshore-hubs and debt financing positions are required to be reported.

Similarly clarification is required as to what circumstances false statements or failure to lodge General Purpose Financial Statements (GPFS) are subject to penalties. There may be situations where an Australian subsidiary is unable to lodge GPFS, or incorrect GPFS statements are lodged, for reasons out of its control.

It is not unusual for GPFS from time to time to be subject to later corrections for errors caused by mathematical mistakes, mistakes in applying Generally Accepted Accounting Principles and International Financial Reporting Standards, or the oversight of facts existing when the financial statements were prepared. Further there may be circumstances where the finalisation of the GPFS may delayed because of actions being undertaking in the foreign head entity's jurisdiction, resulting in the failure to lodge a GPFS on time or even at all for a period. In such circumstances, Australian taxpayers should not be subject to penalties.