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The Principal Advisor
Corporate and International Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email: BEPS@Treasury.gov.au

Response to Australian Treasury Issues Paper Implications of the modern economy for the taxation of multinational enterprises

The Treasury Issues Paper of 3 May 2013 identifies some issues for input concerning the international reform processes initiated by the G20, G8, OECD and other countries and multilateral bodies in the Base Erosion and Profit Shifting (BEPS) update of the international tax settings in relation to the taxation of multinational companies.

Australia is a small open economy, highly reliant on foreign investment to fund the growth of our investments, employment and productivity. So Australia must ensure that the international reforms arising under the OECD BEPS Comprehensive Action Plan achieve results which are positive for Australia. That involves awareness of:

- ▶ The impact on multinational companies based in Australia and operating globally.
- ▶ The ability of Australia and other countries to offer to tax incentives to encourage investment
- ▶ The large scale of the BEPS Comprehensive Action Plan and impact for Australia's tax forward work program
- ▶ Ensuring that Australia's Federal Treasury, government and parliamentary processes are properly resourced to manage the major tasks ahead.

Ensuring adequacy of Treasury policy resources

Australia must plan for the tasks ahead for Australia which will flow from the BEPS Comprehensive Action Plan.

We are concerned that the capacity of the Revenue group in the Australian Treasury to appropriately manage the current policy tasks allocated to it is reduced by the headcount reductions which have taken place in Treasury. The resourcing challenges of the Treasury Revenue Group will become even more apparent if, as widely considered likely, there might arise soon:

- ▶ A possible multilateral tax treaty designed to achieve the OECD and G20 BEPS objectives
- ▶ Potential extensive further treaty adjustments in the medium term to deal with not only the taxation of ecommerce but also approaches to the taxation of permanent establishments
- ▶ Potential treaty and legislative changes for better information exchange by revenue authorities.

These and other elements of the BEPS Comprehensive Action Plan will require Australian tax policy and tax legislative actions.

Also, the BEPS administration initiatives are already affecting and will continue to affect the Australian Taxation Office (ATO) and its capacity to engage in international information exchange, international compliance activities and other initiatives pursuant to this global initiative.

Australia must provide maximum certainty for Australian based multinationals and Australian subsidiaries of global multinationals which is consistent with the global BEPS initiatives, in order to provide Australian businesses into Australia with appropriate confidence about the tax outcomes which arise from their investment.

BEPS Comprehensive Action Plan is distinct from the global efforts to combat tax evasion

The international work on BEPS should be distinguished from the international action to combat tax evasion.

The major tax initiative to combat the evasion of taxes targets actions, usually by private persons, using tax havens and secrecy jurisdictions. Mr Angel Gurría the OECD Secretary-General said in a recent Australian interview¹ that “going after tax havens is easy because you are on the side of the law. All you've got to do is have a tax inspector and a policeman.”

Mr Gurría then summarised the approach in the larger project to update the tax rules for multinational businesses – the BEPS project – as follows:

“But the other problem is that with the multinationals you have a much bigger problem, because we have built a system over the last seventy years since the League of Nations in order to avoid double taxation, but we have produced this double non-taxation.

It's not about bashing the multinationals, we want their investment, we want their job creation capacity, we want their innovative capacity. **The question is really to make sure that there is a better distribution of burden and at the same time that we assure the multinationals that they are not going to be multi-taxed.**” (emphases added)

We are concerned about the risk of inappropriate messaging from Australia's Treasury and government which might impact on investment decisions in Australia. We highlight the need for care in relation to businesses which might have subsidiaries in low tax countries or countries deemed to be secrecy jurisdictions, which might have strong business reasons for those activities. As Mr Gurría stated “It's not about bashing the multinationals The question is really to make sure that there is a better distribution of burden and at the same time that we assure the multinationals that they are not going to be multi-taxed.”

Whether Australia should be concerned if other countries are not taxing income

The reasons why particular foreign countries might not be taxing particular items of income include the desire of countries to attract foreign investment through appropriate targeted tax measures. We note for example Australia's:

- ▶ Reduced tax withholdings on distributions to foreign investors by Managed Investment Trusts
- ▶ Investment Manager regime and
- ▶ Non-imposition of capital gains tax on certain capital gains by non-residents

all of which we support.

So countries' rights to introduce deliberate policy incentives should be considered carefully and retained.

¹ 23 May interview, Australia's ABC program “The Business”:

Priorities in the BEPS Agenda

We do not comment about policy priorities in relation to the BEPS Comprehensive Action Plan. These have already been the subject of extensive discussions among the OECD and G20 countries, and have been the subject of discussions at the OECD Business Investment Advisory Council (BIAC). Media reports have identified the focus on double non-taxation and on subsidiaries which do not have substantial business activities.

We understand that the OECD has already developed early drafts of the workplan in relation to BEPS initiatives, which are circulating to the Australian government.

The Moscow meeting of the Forum for Tax Administration saw the communiqué state that they “stand ready to ensure that any new instruments and standards are applied to maximum effect to eliminate double non-taxation” and will use OECD work on aggressive tax planning and directory of schemes.

Australia’s best interests will be by advocating that the OECD fully consider and debate the matters.

The taxation of hybrid financial arrangements is not a simplistic issue. Double Tax Agreements (DTA) already deal with tax arbitrage on hybrid instruments and entities and this may be the preferred means for dealing with cross border issues. Whether there is double non-taxation is (in general) irrelevant to allocating taxing rights under DTAs. So if there is a change in policy on this matter, then the change should be implemented through bilateral or multilateral agreement under the DTAs.

In relation to the global taxation of ecommerce, Australia should ensure there is transparent and extensive discussion about the principles to be adopted. There is a risk to Australia if there is a move by countries in which the consumers are located (the ‘consumer’ countries or source countries) to impose taxation in an unprincipled manner on ecommerce activity. Such rules might apply to Australian companies exporting commodities, manufactures and services, leading to new taxes imposed by foreign ‘consumer countries’ which do not arise currently. So this issue has implications for Australia’s interests.

Evidence of Base Erosion and Profit Shifting in Australia

We agree there is no clear evidence of BEPS activity having a major impact on Australia’s tax revenues.

Indeed, using the analysis of corporate income taxes as a percentage of gross domestic product (GDP), contained in the OECD February BEPS paper, Australia has the highest percentage of corporate income tax to GDP of any OECD country with the exception of Norway (whose numbers are inflated because of its petroleum resource taxation).

As Treasury has previously identified, Australia’s corporate tax to GDP ratio has been affected by the major resource company capital investments to build productive capacity, which will give rise to substantially increased corporate tax revenues in the future, but which have led to capital allowance tax deductions which are wholly legitimate. However, the impact of the capital allowance claims is not permanent.

Importantly, Australia’s dividend imputation system means that that the likelihood of BEPS activity by Australian listed public companies is substantially less than arises in other countries. Australian listed companies have, broadly, a great desire to pay franked dividends to their investors because franked dividends enhance their share price. For private companies also, franked dividends enhance Australian investors’ after-tax positions. Thus Australia’s tax system encourages Australian listed and Australian owned companies to concentrate their tax payments in Australia.

We emphasise the dividend imputation impact for two reasons:

- ▶ It is a significant reason why concerns about perceived BEPS adverse effects on Australian corporate tax revenues are muted when compared with other countries, and
- ▶ There is a risk that the OECD BEPS project might lead to Australian based companies having higher taxes attributable to other countries, paying more taxes in other countries, and correspondingly reducing the relative corporate tax revenues of Australia.

When considering the evidence of BEPS and also to drive Australian policy, we suggest there is a wealth of statistical information which is collected by the ATO which should be captured and interpreted to enable policy analysis. The ATO has made huge investments in IT capacity, and the ATO collects extensive business information such as:

- ▶ Extensive information drawn from company income tax returns.
- ▶ A comprehensive International Dealing Schedule (IDS) introduced for all businesses with international activities with effect from the year ended 30 June 2012 (replacing the Schedule 25A form of earlier years) and which has been operational for financial services companies for earlier years.
- ▶ Extensive risk analysis materials produced for purposes of classifying businesses, particularly large businesses, into its risk quartiles for compliance and audit purposes.
- ▶ Extensive access to other information in the economy including cash movements through Austrak which are occasionally referred to when the ATO analyses movements and transactions involving specific tax haven and other jurisdictions.
- ▶ Transfer pricing advanced pricing agreements and negotiations which have been entered into many large companies.
- ▶ Other materials such as the ATO reportable tax positions schedules and other materials produced by multinational businesses for the ATO.

So there is no requirement to build major new reporting infrastructures. The focus should be on efficient use and better information drawn from the resources and data which are available to the ATO.

Future involvement in the BEPS Processes

The global BEPS Comprehensive Action Plan is likely to see a great volume of change in the international tax rules (both in double tax treaties and domestic tax changes).

We welcome the ability to consult with the Australian government, Treasury and ATO as they consider the eventual reforms going forward, with a view to assisting them to deliver what will hopefully be a positive outcome for Australia and multinationals which support investment in Australia.

If you need any further information please do not hesitate to contact, in the first instance, me on (02) 8295 6473 or Tony Stolarek on (03) 8650 7654.

Yours truly

Alf Capito
Partner Tax Services | Tax Policy Leader Asia Pacific