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Taxation Committee

Taxation of multinational enterprises

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Submission

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Introduction

The NSW Young Lawyers Tax Law Committee (NSWYLC) refers to the Treasury's Issues Paper entitled "Implications of the Modern Global Economy for the Taxation of Multinational Enterprises" (the issues paper).

NSW Young Lawyers, a division of the Law Society of NSW, is made up of legal practitioners and law students, who are under the age of 36 or in their first five years of practice. Our membership is made up of some 13,000 members.

The NSWYLC provides education to the legal profession and wider community on current and future developments in taxation law, and identifies and submits on issues in need of law reform.

Should another country not exercising its right to tax be of concern to Australia?

The NSWYLC agrees with the issue paper's comments that where multinational enterprises (MNEs) are paying little or no tax in any country, they may be taking advantage of the explicit policy settings put in place by one or more countries to attract investment.

This environment of differing incentives across a number of jurisdictions creates the opportunity for MNEs to effectively arbitrage each incentive to reduce their global effective tax rate.

Solutions to this problem have been considered in other jurisdictions that include modified territorial or worldwide approaches to taxation that may include a universal tax rate for MNEs in each jurisdiction in which they operate.[1]

The common denominator for each possible solution to the arbitrage of jurisdictional tax incentives is the requirement of unilateral action to remove particular incentives in each jurisdiction.

Taking this into consideration, if Australia is concerned over another country not fully exercising its right to tax, the possible actions could include one or more of the following:

1. Removing explicit policy settings that attract certain kinds of investment;[2]
2. Introducing innovative policy settings that change the MNE tax base in Australia;
3. Improving the current base erosion and profit shifting protections available in the Australian corporate tax regime;[3] or
4. Implementing changes to Australia's corporate tax regime to take into account the tax treatment of MNEs in other jurisdictions.

The difficult issue identified by the NSWYLC is the correct level of action that should be taken if another country is not fully exercising its right to tax. The difficulties identified with each action above are discussed below:

1. The removal of explicit policy incentives that attract certain kinds of investment will axiomatically result in more revenue being collected from MNEs however it will also result in that same investment no longer being attractive in Australia.

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1 See; Congress of the United States; Congressional Budget Office, *Options for Taxing U.S. Multinational Corporations*, January 2013, 3 (CBO Report).
2 This has already been contemplated by the recent Federal Budget in Australia which included a number of possible changes to the international tax framework. See; Commonwealth, Budget Measures 2013-14, Budget Paper No.2 (2013).
3 Ibid.

2. The introduction of an innovative tax to better capture the economic activity of an MNE in Australia's may be difficult to effectively implement or result in increased compliance costs for taxpayers;

3. Modifications to current base erosion and profit shifting rules may have a similar effect discussed at 1 above or not being an effective means of preventing profit shifting by MNEs; and

4. By directly taking into account the explicit policy settings of another jurisdiction in deciding how an MNE should be taxed in Australia may circumvent the incentive offered in a foreign jurisdiction. This may result in the incentives offered under the Australian tax regime being curtailed by the tax actions of foreign countries.

Despite these difficulties, it is accepted that Australia, along with a number of other OECD countries, are taking the steps identified at 1 and 2 above in an effort to preserve the corporate tax base in their respective jurisdictions.

In addition, some OECD countries have corporate tax regimes that take into account the tax rate of other jurisdictions where the tax rate of the foreign jurisdiction is outside a prescribed ratio.[4]

These actions have been unilateral in an effort to address issues with each jurisdictions tax regime. Failing a concerted universal effort of a number of countries to multilaterally address double non-taxation, unilateral action is the only avenue available to Australia to improve the integrity of its tax regime.

On this basis, the NSWYLC recommends that Australia should not be concerned with another country not fully exercising its right to tax.

Is there evidence of BEPS in Australia?

We agree with the issue paper's comments that, due to the multi-jurisdictional nature of BEPS, it is difficult to ascertain the extent of BEPS in Australia. In the absence of available data, NSWYLC therefore cannot form a view as whether evidence of BEPS exists in Australia.

There can be no doubt, however, that BEPS occurs around the world. The anomalous flow of foreign investments must be a symptom of BEPS globally[5]. Further, when conducive conditions for the existence of BEPS, such as disparities between corporate tax rates and antiquated permanent establishment rules, align with an increased mobility of intellectual property and other capital, it is reasonable to assume that multinationals become commercially incentivised to bifurcate the location of income producing assets in jurisdictions separate from the economic source of the income.

Fixing any problem first requires understanding the problem. NSWYLC therefore agrees that a robust information gathering framework is necessary in order to assess the existence of BEPS in Australia.

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4 CBO Report, 4.

5 For example, in the OECD report *Addressing Base Erosion and Profit Shifting* (at page 17) raised the following anomalous investment results:

> "The OECD and depth analyses of these data could be useful. For example, by researching through the IMF Co-ordinated Direct Investment Survey (CDIS), it emerges that in 2010 Barbados, Bermuda and the British Virgin Islands received more [Foreign Direct Investments] (combined 5.11% of global FDIs) than Germany (4.77%) or Japan (3.76%). During the same year, these three jurisdictions made more investments into the world (combined 4.54%) than Germany (4.28%). On a country-by-country position, in 2010 the British Virgin Islands were the second largest investor into China (14%) after Hong Kong (45%) and before the United States (4%)… Similar data exists in relation to other countries, for example Mauritius is the top investor country into India."

Is sufficient data available?

NSWYL submits that rather than broadening the base of data that is collected from taxpayers, there may be pre-existing opportunities within the current information gathering framework to obtain data relevant to the assessment of BEPS. Attempting to gather further information would prove costly to taxpayers and may be unnecessary in light of the existing information available to Treasury.

We have outlined where the NSWYLC sees information-gathering opportunities within the existing framework below:

Australian Transaction Reports and Analysis Centre (AUSTRAC) data

AUSTRAC is the government agency responsible for monitoring offshore movements of currency resulting from certain "international funds transfer instructions". An "international funds transfer instruction" is an instruction for a transfer of funds that is transmitted into or out of Australia electronically or by telegraph (excluding certain instructions of a prescribed kind). Broadly, section 17B of *Financial Transactions Act 1988* (Cth) requires certain cash dealers (including banks) to prepare and submit a report to AUSTRAC, in an approved form, including details of such instructions.

Amongst other details, the "approved form" of the international funds transfer instruction requires details concerning the sender of the instruction's name, the recipient and the amount of funds transferred[6].

Interestingly, section 17B was inserted following a recommendation arising from a Senate Committee's inquiry into international profit shifting[7]. In recommending the amendment, the Committee noted:

> 5.27 The capture and analysis of telegraph transfer data would add a significant dimension to the ability of the ATO and law enforcement agencies to strike at the major incentive behind international organised crime - financial gain. In addition, **the intelligence provided by this data should enhance the ATO's ability to detect and investigate international profit shifting arrangements… (emphasis added)[8].**

While legitimate global structuring arrangements that may give rise to BEPS under the issues paper are clearly distinct from those pertaining to international organised crime, the information gathering abilities presented by section 17B are equally useful in identifying international profit shifting in the context of the issues paper. The ATO's ability to disseminate and review the information provided by AUSTRAC, would, as acknowledged by the Committee represent valuable data for examining the existence of BEPS. In particular, the information provided to AUSTRAC in relation to international funds transfer instructions should be able to demonstrate offshore income flows to jurisdictions regarded as "tax havens" as well as the types of anomalous offshore income flows noted by the OECD above.

AUSTRAC also has the ability to share financial transaction information and intelligence with its international counterparts. While exchange of information articles in tax treaties enable the ATO to do this to a limited extent, AUSTRAC's "information sharing" network

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6 See *Financial Transaction Reports Regulations 1990* (Cth) - Regulation 11AA - Prescribed Details in relation to an international funds transfer instruction

7 *Follow the yellow brick road - the Final Report on an efficiency audit of the Australian Taxation Office: International Profit Shifting*, House of Representatives Standing Committee on Finance and Public Administration, March 1991.

8 Ibid (at para 5.15)

has a currently greater breadth than Australia's treaty network[9] and may be a practically easier means of gathering such information.

Data sharing between AUSTRAC and the ATO is already happening. In 2011-2012 a "major beneficiary" of AUSTRAC's information was the ATO, resulting in $252 million in additional tax assessments being raised[10]. As of 30 June 2012, the ATO had the largest number of users with online access to AUSTRAC information[11] and has recently worked with AUSTRAC to investigate multi-jurisdictional matters on Project Wickenby.

NSWYLC submits that AUSTRAC's existing information gathering ability should give rise to sufficient data to detect the existence of BEPS. To ensure only relevant data is collect, Treasury and the ATO should work collaboratively with AUSTRAC to develop a set of guidelines to support the types of data that should be gathered to study BEPS.

Current ATO information gathering powers

The Commissioner currently has significant powers under section 264(1)(a) of the Income Tax Assessment Act 1936 to obtain foreign bank account details. Specifically, section 264(1) provides that:

> "(1) The Commissioner may by notice in writing require any person, whether a taxpayer or not, including any officer employed in or in connexion with any department of a Government or by any public authority:
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> (a) to furnish the Commissioner with such information as the Commissioner may require; and
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> (b) to attend and give evidence before the Commissioner or before any officer authorized by the Commissioner in that behalf concerning the person's or any other person's income or assessment, and may require the person to produce all books, documents and other papers whatever in the person's custody or under the person's control relating thereto.
>
> (2) The Commissioner may require the information or evidence to be given on oath or affirmation and either verbally or in writing, and for that purpose the Commissioner or the officers so authorized by the Commissioner may administer an oath or affirmation.
>
> (3) The regulations may prescribe scales of expenses to be allowed to persons required under this section to attend."

The recent result in *Australia and New Zealand Banking Group Ltd v Konza* [2012] FCAFC 127 (**the ANZ Case**), affirms the breadth of the information gathering power provided by section 264. Relevantly to BEPS, the ANZ case demonstrated that the Commissioner can compel an Australian entity to provide information, even where the disclosure of that information is in contravention of a foreign law.

There is also the power to issue a section 264A "Offshore information notice" requesting information of documents relevant to the assessment of a taxpayer that are held outside of Australia.

NSWYLC submits that Commissioner's significant ability to obtain information from taxpayers under section 264(1)(a) and 264A offers another avenue for Treasury to gather specific kinds of data required to study the existence of BEPS.

Information gathered from current compliance obligations

In addition to our comments above, we believe that the information contained on a company's International Dealings Schedule and Reportable Tax Position (RTP) Schedule

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9 As at 30 June 2012, AUSTRAC had 63 MOU's in place with overseas jurisdictions compared with Australia's 44 tax treaties. This included MOUs with the Cayman Islands, Bermuda, Vanuatu and several other jurisdictions regarded as "tax havens".
10 AUSTRAC Annual Report 2011-2012
11 Ibid p 61

(if applicable) should also provide valuable information to Treasury regarding profit shifting.

We understand that, as part of its 2012-2013 compliance program, the ATO indicated that it would contact its largest taxpayers (around 170 for the 2012-2013 income year) requiring them to lodge the RTP schedule. As this program is expanded, an increasing amount of information should be available from the RTP Schedules.

We also note that the dividend and interest schedule lodged as part of a taxpayer's annual tax return as well as the PAYG withholding from interest, dividend and royalty payments paid to non-residents - annual report may also provide data relevant to studying BEPS.

Benefits and costs of requiring companies to provide more detailed information to the ATO

As the above compliance requirements may already, as a practical matter, involve a significant degree of time and cost for a taxpayer, and in light of the other information available detailed above, NSWYLC is of the view that the benefit to Treasury of introducing any additional compliance requirements to assess BEPS would not outweigh the compliance cost to taxpayers.

Views are sought on whether the key pressure areas identified by the OECD represent the main priorities for action in the short term. If so, what should be the shape of measures to address these pressure areas. If not, what areas should be the focus of the action?

NSWYLC agrees that the key pressure areas[12] represent the main priorities for action in the short term. In particular, any action plan should include "*updated solutions to the issues related to jurisdiction to tax, in particular in the areas of digital goods and services. These solutions may include a revision of the treaty provisions.*"

We agree that there may be a case for the international recognition of "permanent virtual establishments." However the BEPS problem must be fully understood before any change is implemented. In moving towards a regime that is sustainable and sensible for both corporations and governments, we submit that any change should be implemented incrementally.

Some scholarly observers recommend that a "destination based tax" should be considered as a means to address base erosion.[13] The NSWYLC is of the view that this should be considered. A destination principle would be similar to the principles underlying the consumption tax system. A destination based tax is an opportunity for individual governments to tax based on the consumption in their jurisdiction.

With clear rules to determine the location of consumers, a destination tax may be less distorting than the current regime. In this regard, a destination tax may not affect investment decisions and financing decisions.

NSWYLC submits that any change should be implemented incrementally.

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12 OECD Report "*Addressing concerns relating to a base erosion and profit shifting*" (2013) page 52.
13 Said Business School, Oxford "*Taxing Multinationals Conference*" (2013), Michael Devereux.

The NSWYLC is grateful to Treasury for the opportunity to make this submission.

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