THE TAX INSTITUTE

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Dear Gerry

IMPROVING THE TRANSPARENCY OF AUSTRALIA'S BUSINESS TAX SYSTEM

The Tax Institute thanks Treasury for the opportunity to make this submission in response to the Discussion Paper entitled "Improving the transparency of Australia's business tax system" dated 3 April, 2013 (the "**Discussion Paper**").

Overview

Transparency of tax payable by "large and multinational businesses"

The challenges facing our business tax system have changed significantly in the past few decades. The Tax Institute is broadly supportive of the Government's goal of ensuring that an appropriate rate of tax is levied on the economic profit generated in Australia or by Australian enterprises.

However, it is our view that an appropriate rate of taxation can only be imposed on such profits via well-conceived and drafted tax laws, and in conjunction with our international treaty and trading partners. That is, a taxpayer's obligation to pay their "fair share" of tax in Australia cannot be imposed via any means other than clearly defined laws, as made by the Australian Government. Taxpayer obligations should begin and end with compliance with the tax law.

We concur with the view that our taxation laws should reflect the values of the taxpaying community. As such, we welcome an informed debate about the appropriateness of current tax settings as well as the merits of any changes to our tax system being considered.

Transparency as to the tax affairs of certain taxpayers may assist in informing such a debate – if the information is meaningful, relevant and explained and debated in context.

The Assistant Treasurer's media release of 4 February 2013 notes that transparency will "allow the public to better understand the business tax system and engage in debates about tax policy."

However, the tax system is complex and contains a multitude of bespoke tax treatments and concessions that have been specifically developed over time in conjunction with Government policy.

There is a high risk that the disclosed information will result in misunderstanding, especially without the necessary context about the business tax system and the particular facts and circumstances of the company. That is, the proposed disclosures risk causing widespread confusion rather than illumination, ultimately detracting from the objective of tax transparency.

Companies that have acted legally and legitimately, risk being unfairly tarred with the "tax avoidance brush" unless the Government treats disclosed information with sensitivity and takes responsibility for educating the community on the complexities of our business tax system. Exposure of company tax data on an entity by entity basis may aid, but does not in and of itself constitute, a sophisticated debate about taxation policy.

This will be especially the case for multinationals, as for such taxpayers Australia is only one of many jurisdictions in which tax is paid. The Australian tax liability of such taxpayers contributes to the organisation's global effective tax rate and payments.

We acknowledge that the stakeholders of many companies extend far beyond shareholders to include employees, debtors, creditors, suppliers etc, and that as a result many companies are already required to disclose significant amounts of information via the requirement to lodge financial statements with the Australian Securities and Investment Commission ("**ASIC**").

We recommend that the Government further explores whether the objectives of this initiative may be better achieved via amendment of reporting requirements under the *Corporations Act 2001*. These reporting requirements have historically and in the present day fulfilled a valuable function of keeping relevant stakeholders informed as to the present and planned activities of the relevant company or economic group. The disclosure of additional information in this manner will allow tax information to be considered in context, allow greater transparency in relation to the economic substance of the transaction and could require additional disclosures deemed necessary via the notes to the financial statements.

We also recommend that in order to protect the confidentiality of tax information of individuals and small businesses as per the Assistant Treasurer's media release of 4 February, 2013, the tax transparency threshold be set so as to exclude as many closely held companies as possible, and at total income of $250 million. This threshold will exclude most closely held private companies and is consistent with the Australian Taxation Office's ("**ATO**") internal administrative boundary between "small to medium" and "large business" taxpayers.

Notwithstanding the above, understanding the business tax system and building community consensus for action is only the first step. To ensure that enterprises "pay their fair share of tax" in accordance with the law, community consensus should feed into broader efforts to evaluate and if necessary change our domestic tax laws and

international tax treaties (in conjunction with our treaty partners). We look forward to consulting with the Government on this broader project in due course.

Publishing aggregate collections for each Commonwealth tax

We are broadly supportive of the policy underpinning the publication of aggregate collections for each Commonwealth tax. Such information is essential to facilitate informed debate over the appropriateness of our current tax settings and tax reform proposals.

Enhanced information sharing between Government agencies

We are broadly supportive of the policy underpinning enhanced information sharing between Government agencies, provided that such sharing does not lead to the circumvention of current intended limitations to the collection of that taxpayer information by the receiving Government agency.

Our specific comments on the Discussion Paper are set out below.

Policy intention

The Discussion Paper and the Assistant Treasurer's media release note that the transparency measure is intended to:

- Encourage enterprises to pay their fair share of tax;
- Discourage aggressive tax minimisation practices; and
- Allow the public to better understand the business tax system and engage in debates about tax policy.

It is our view that first two of the three objectives set out above should occur only via sound administration, review of existing tax laws and changes in the same if necessary.

Tax transparency may, however, assist in informing the public debate about how our tax laws should operate if greater information leads to greater understanding. As noted above, this can only occur if the Government treats disclosed information with sensitivity and takes responsibility for educating the community on the complexities of our business tax system.

Greater transparency to Government may also assist administrators and policy makers in staying ahead of the curve. However, any additional information required by administrators and policy makers in relation to the use of 'complex arrangements and contrived corporate structures' should be obtained via the income tax return and disclosed to the Government only. We would be pleased to discuss any perceived shortfalls in information collection via the company income tax return with Treasury and the ATO in greater detail.

Our submission below is based on our understanding that the transparency project is intended to form part of the Government's efforts to tackle profit shifting by multinationals, perceived to be resulting in an erosion of the corporate tax base.

Our understanding is based on:

- the Assistant Treasurer's earlier media release of 10 December, 2012 announcing the formation of the *Specialist Reference Group* on multinational taxation in which it was noted that this process was intended to supplement "Treasury's examination of multinational tax minimisation strategies and its risks to the sustainability of Australia's corporate tax base"; and

- the Assistant Treasurer's recent address to The Tax Institute's National Convention on 15 March 2013.

Should our characterisation of the context of this initiative be incorrect, we would be pleased to discuss.

Section 1: Transparency of tax payable by "large and multinational businesses"

Our comments below relate to the proposal included in Treasury's Discussion Paper under the same heading.

However, we reiterate our recommendation that the Government further explores whether the objectives of this initiative may be better achieved via amendment of reporting requirements under the *Corporations Act 2001*.

As above, these reporting requirements are in our view a better avenue by which to inform relevant stakeholders (including the Australian and other Governments) as to the present and planned activities of the relevant company or economic group, and will:

- allow tax information to be considered in context,
- allow greater transparency in relation to the economic substance of the relevant transaction; and
- could require additional disclosures deemed necessary via the notes to the financial statements.

Nevertheless, should the Government proceed with the proposal set out in the Discussion Paper, our detailed comments are below.

Domestic vs. multinational companies

If the transparency initiative is intended to better inform the public about the taxation of multinationals, including the nature and scope of base erosion and profit shifting, it is unclear to us why the initiative is proposed to also apply to wholly domestic companies of any size.

This is especially so since it is our understanding that it is possible and relatively cost-effective to identify companies without any international related-party dealings from current disclosures on the company income tax return.

If the intention underpinning the inclusion of domestic companies is to provide an industry benchmark against which the tax burden borne by multinational enterprises operating in the same industry may be considered, it is our view that such comparisons are ill-informed and improper.

This is because, unlike wholly domestic companies, multinational enterprises will have:

- access to suppliers, trade agreements and markets;
- foreign exchange exposure; and
- tax liabilities in foreign jurisdictions.

As such, we recommend that the Government clarify and explain the perceived need to apply the transparency initiative to wholly domestic companies as well as multinationals.

"Large" companies

We are cognisant of the many varying definitions of "small", "medium" and "large" businesses that exist from the perspective of tax laws (including with respect to *de minimis* carve outs), the ATO (including in the ATO's *Taxation Statistics* publication) and ASIC. We are also cognisant that the standard used to apply these tests varies from turnover, business income, asset value, number of employees etc.

We appreciate Treasury's recognition of the need to carve out companies below a certain threshold in order to safeguard the confidentiality of tax information of individuals and small businesses (as per the Assistant Treasurer's media release of 4 February, 2013).

In light of the stated policy intention underpinning this initiative, it is our view that the transparency threshold should be set with a view to excluding as high a proportion of closely held companies as possible.

This is because:

- The disclosure of tax information of closely held, potentially wholly-domestic companies is inappropriate and risks inadvertently disclosing details of some of the tax circumstances of the ultimate individual owners;
- It is unnecessary to include many small to medium enterprises in the transparency initiative in order to fulfil the Government's stated policy intention/s; and
- Many large multinationals that have no significant Australian tax presence (because, for instance, the enterprise makes significant sales into Australia but has no permanent establishment here) are unlikely to be included on the list unless the threshold is significantly lower than $100 million of business income;

We agree that the setting of a threshold based on information that may be gleaned from the company income tax return will not, *prima facie*, increase compliance costs. On this basis, we consider the use of either "Total Income" (Label S, Question 6) or "Total profit or loss" (Label T, Question 6) to be most appropriate, rather than for example tests based on quantum of salary and wages, number of employees, asset value or ultimate ownership.

If the relevant threshold is to be set with reference to "Total Income" at Label S (as per the Discussion Paper) we recommend that the ATO's classifications for the purposes of

its internal administrative arrangements[1] be relied upon, as these thresholds reflect the ATO's experience in relation to the tax issues that are prevalent in each market segment.

Classification	**Turnover**
Micro-enterprises	Less than $2 million
Small-medium enterprises	$2 million to $10 million (S1)
	$10 million to $50 million (S2)
	$50 million to $100 million (S3)
	$100 million to $250 million (S4)
Large businesses	Greater than $250 million

We note that differences in concepts of "total income" and "turnover", and "company" and "enterprise" are not sufficiently significant to lessen the relevance of these classifications.

The Inspector-General of Taxation relevantly noted recently in the Report on his *Review into the ATO's compliance approaches to small and medium enterprises with annual turnovers between $100 million and $250 million and high wealth individuals* (i.e. the S4 market segment):

> *The Australian Taxation Office (ATO) identifies small and medium sized enterprises with annual turnovers between $100 million to $250 million (larger SMEs) as a particular compliance focus. There are approximately 1400 larger SMEs, over half of which are controlled by individuals with more than $30 million in net wealth.*
>
> *…*
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> *Even within the S4 market segment and of the SME business line's work, there are a variety of taxpayers. Around 50 per cent of the S4 market segment is part of a CHPG [closely held private group], around 30 per cent are foreign controlled groups, around 15 per cent are public groups, around six per cent are other widely held groups (such as limited partnerships, managed investment schemes, etc.) and around two per cent are non-profit making groups.*

In light of the significant percentage of companies in the $100 million to $250 million total income bracket that are likely to be part of a closely held private group, we recommend that the relevant threshold be raised to $250 million, to align with the threshold at which the ATO's internal definition of "large businesses" commences.

Total income of the "taxpayer"

We have presumed that the threshold will apply in relation to the taxpayer in question, and that this will be the head company of an income tax consolidated group or multiple-entry consolidated ("**MEC**") group, if relevant.

It should be noted that the membership of an income tax consolidated group is unlikely to align with the membership of the consolidated entity for financial reporting purposes due to differing consolidation rules. This differing membership will likely render

[1] As set out in the ATO's 2012-13 Compliance Program

comparisons between accounting and tax data irrelevant and incomprehensible. The disclosure made by the Commissioner should be preceded by an advisory explanation to this effect.

Where the relevant taxpayer is instead a MEC group, there is likely to be even less comparability between accounting and tax data, as multiple MEC groups may be part of the same ultimate economic enterprise. Furthermore, which MEC groups are part of the same economic enterprise may not be easily discernible. In some cases, only some of the MEC groups that are part of the same economic enterprise will be above the relevant disclosure threshold. The disclosure made by the Commissioner should be preceded by an advisory explanation to this effect.

The Government should endeavour to explain the above complexities to the community to ameliorate the likely confusion and capacity for misunderstanding that will arise from disclosure in relation to consolidated and MEC groups.

The disclosures: Total income, Taxable income, Income tax

The disclosure of such limited headline numbers which bear little to no relationship to each other or to relevant accounting data is likely to prove confusing at best and misleading at worst.

This is because:

- As total income is a gross number, it is not related in any meaningful way to "taxable income", which is a net number. Persons analysing the disclosed data may not easily comprehend the significant difference between the two numbers.

- There are a range of reasons why total income as per the income tax return may differ from gross revenue for accounting purposes, and why total profit or loss on the income tax return may differ from taxable income. Many of these reasons relate to differences in accounting and taxation treatment of the same transaction, such as in relation to:

    - treatment of capital gains (as defined in the tax law);
    - the Taxation of Financial Arrangements regime;
    - tax treatment of bad debts;
    - income tax consolidation regime;
    - research and development tax concessions;
    - differing tax and accounting depreciation rates;
    - differing tax and accounting treatment of goodwill;
    - accounting entries in respect of assets such as impairment charges or writebacks;
    - differences in the recognition of carried forward losses;

    - controlled foreign company income; and
    - treatment of non-assessable non-exempt income e.g. section 23AJ dividends and section 23AH foreign branch profits.
- Income tax may differ from 30% of taxable income, due to tax attributes such as foreign income tax offsets and franking credits.

The misunderstanding that is likely to result from the disclosure of these headline tax numbers gives rise to a significant potential for reputational risk to law-abiding companies that may be unfairly tarred with the tax avoidance brush.

Many of these companies will have relied on Government-sanctioned complex tax treatments, which represent a reasonable outcome for the Government and taxpayers alike – even if the outcome differs from the accounting treatment.

The Government should take responsibility for ensuring that the public is sufficiently well-educated as to these potential differences in order to facilitate an informed and nuanced debate on the appropriateness of our current business tax system settings.

A failure to do so will jeopardise foreign investment due to the heightened reputational risk profile of investing in Australia, and allow law-abiding citizens to be caught in the cross-fire.

Point in time disclosure

There remain significant difficulties with the making of a "point in time" disclosure by the Commissioner, such as:

- When will tax return data be disclosed for taxpayers with a substituted accounting period?
- As disclosures will reflect data included on lodged tax returns only, will the lodgment of an amended assessment, amounts in dispute or under audit be noted/disclosed in subsequent years?
- What data will be disclosed in relation to companies that have not lodged their income tax return by the due date? This will be especially relevant if companies are expected or likely to be above the threshold (for example, because their prior year return disclosed total income higher than the threshold). We recommend that the Government clarify the policy intention with respect to whether the non-lodgment by such companies will be required to be disclosed.

Timing and nature of disclosure

We broadly agree that disclosure by the Commissioner rather than by the taxpayer in the first instance is not likely to add to compliance costs.

However, we anticipate that taxpayers may nevertheless seek to make additional disclosures in relation to their tax affairs in order to contextualise the disclosure by the Commissioner. As such, sufficient time should be afforded to taxpayers for the collation

and voluntary disclosure of additional tax information ahead of the disclosure by the Commissioner.

This is especially so since the voluntary disclosures that companies may choose to make may extend well beyond the scope of Australian corporate tax. Many companies are liable to satisfy taxation liabilities beyond income tax, Minerals Resource Rent Tax and Petroleum Resource Rent Tax both in Australia and in other jurisdictions. For example, voluntary disclosures may incorporate a more comprehensive suite of taxes, levies and duties that a company is liable to pay both in Australia and in foreign jurisdictions.

In this regard, we consider that disclosure by the Commissioner should only be made at least three months after the due date for lodgment of the company's income tax return.

We also recommend that close consideration be given to linking information voluntarily provided by taxpayers and information disclosed by the Commissioner, such as via the cross referencing of websites, with appropriate caveats included.

For example, the relevant company could be given the opportunity to provide the Commissioner a link to the taxpayer's website that contains additional information, at any time before the planned disclosure. Such a link could then be included beside the disclosure, caveated to note that the information has been provided by the taxpayer and has not been verified by the ATO.

An example is as follows:

Name	**ABN**	**Total income**	**Taxable income**	**Income tax**	**Further information provided by taxpayer** **NOTE: This information has not been reviewed or verified by the ATO.**
A1 Ltd	10 234 567 890	$500,000,000	$400,000,000	$120,000,000	www.A1.com.au/tax
B1 Ltd	97 876 543 210	$300,000,000	$101,000,000	$10,000,000	www.B1.com.au/tax
C1 Ltd	10 293 847 756	$120,000,000	-	-	www.C1.com.au/tax

We anticipate that increasing the ease with which such additional information may be accessed will reduce the likelihood of misunderstanding and mis-reporting.

Section 2: Publishing aggregate collections for each Commonwealth tax

We are broadly supportive of the policy underpinning the proposed changes in section 3 of the Discussion Paper. Information as to the aggregate collection for each Commonwealth tax is essential to facilitate informed debate over the appropriateness of our current tax settings and tax reform proposals.

Section 3: Enhanced information sharing between Government agencies

We are broadly supportive of the policy underpinning the proposed changes in section 4 of the Discussion Paper.

The agencies to which the Commissioner may disclose taxpayer information and the purpose to which shared information can be put by the receiving Government agency should be clearly stipulated in the amending legislation (as set out on page 11 of the Discussion Paper). Such stipulations are essential to ensure that current limitations to the collection of information directly from taxpayers by other Government agencies are not circumvented via the proposed amendment, unless specifically intended.

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Should you wish to discuss any of the above, please do not hesitate to contact either me or Tax Counsel, Deepti Paton on 02 8223 0044.

Yours sincerely

Steve Westaway
President