tax justice network Australia

31 May 2013

Principal Adviser
Corporate and International Tax Division
The Treasury
Langton Crescent
PARKES, ACT, 2600
Email: beps@treasury.gov.au

Submission to Issues Paper on Implications of the Modern Global Economy for the Taxation of Multinational Enterprises

The Tax Justice Network Australia (TJN-Aus) welcomes this opportunity to make a submission on the *Implications of the Modern Global Economy for the Taxation of Multinational Enterprises* issues paper. The TJN-Aus sees taxation as playing a vital role in ensuring a just society and a just world.

The TJN-Aus agrees with the OECD that tax dodging by multinational companies can "produce unintended and distortive effects on cross-border trade and investment" and that "it distorts competition and investment within each country by disadvantaging domestic players".[1] Further multinational companies engaged in tax dodging "may profit from these opportunities and have unintended competitive advantages compared with other businesses, such as small and medium-sized enterprises, that operate mostly at domestic level."[2]

Recommendations

The TJN-Aus makes the following recommendations to address base erosion and profit shifting. The Australian Government should:

1. Give strong support to the OECD project 'Tax Inpsectors Without Borders' in both funding and in providing experts for the program to assist developing countries in combating tax evasion and tax avoidance.
2. Require Multinational Enterprises (MNEs) to submit a worldwide combined report, including consolidated accounts, to the Australian Taxation Office and the report should provided a country-by-country breakdown of the enterprise's employees, physical assets, sales, profits and taxes actually due and paid.
3. Support the development of a new international norm to eventually replace the OECD arm's length principle using combined reporting, with formulary apportionment and Unitary Taxation. This would prioritise the economic substance of a multinational and its transactions, instead of prioritising the legal form in which a multinational organises itself and its transactions.
4. Continue to support automatic information exchange between tax authorities as the new global norm, especially as the incoming President of the G20.
5. Implement measures that seek to penalise secrecy jurisdictions that refuse to provide effective information exchange to encourage them to comply with automatic information exchange and other global standards addressing money laundering, tax avoidance and tax evasion. Such measures should include:

[1] OECD, 'Addressing Base Erosion and Profit Shifting', OECD Publishing, http://dx.doi.org/10.1787/9789264192744-en, 2013, p. 39.
[2] OECD, 'Addressing Base Erosion and Profit Shifting', OECD Publishing, http://dx.doi.org/10.1787/9789264192744-en, 2013, p. 39.

- Disallowing deductions or credits with respect to transactions with residents of a jurisdiction that does not effectively exchange information (which is already used by Argentina, Brazil, Germany, India and Italy);
- Applying higher rates of withholding taxes on all transfers of funds to jurisdictions that do not engage in effective information exchange (which is already used by Argentina, France, Mexico and the Slovak Republic);
- Deeming funds received from a secrecy jurisdiction that does not provide automatic information exchange to be assessable income; and
- The application of administrative measures which discourage companies from using non-co-operative jurisdictions, such as reversing the burden of proof, higher audit requirements and requiring records to be kept for 20 years rather than the standard five years for records involving the use of secrecy jurisdictions that do not commit to automatic information exchange).

6. Introduce a requirement for a public register of the ultimate beneficial owners of companies, given the role shell companies and special purpose entities play in both tax dodging and many forms of illicit flows.[3] Australia should also support this becoming a global standard.
7. Introduce legislation, modelled on US legislation, to protect and reward private sector whistleblowers that expose tax evasion, tax avoidance and fraud against all levels of government in Australia. The reward should be a proportion of any funds recovered as a result of the information provided by the whistleblower.

Table of Contents

Recommendations 1
Background on the Tax Justice Network Australia 3
Question 1 4
Question 2 6
Question 3 8
    3.1 Increased Transparency 8
    3.2 Transfer Pricing 14
    3.3 Automatic Information Exchange between Tax Authorities 20
    3.4 Disclosure of Ultimate Beneficial Owner 24
    3.5 Private Sector Whistleblower Protection 25

[3] Global Witness, 'Undue Diligence. How banks do business with corrupt regimes', March 2009, pp. 109-111.

Background on the Tax Justice Network Australia

The Tax Justice Network Australia (TJN-Aus) is the Australian branch of the Tax Justice Network (TJN). TJN is an independent organisation launched in the British Houses of Parliament in March 2003. It is dedicated to high-level research, analysis and advocacy in the field of tax and regulation. TJN works to map, analyse and explain the role of taxation and the harmful impacts of tax evasion, tax avoidance, tax competition and tax havens. TJN's objective is to encourage reform at the global and national levels.

The Tax Justice Network aims to:
(a) promote sustainable finance for development;
(b) promote international co-operation on tax regulation and tax related crimes;
(c) oppose tax havens;
(d) promote progressive and equitable taxation;
(e) promote corporate responsibility and accountability; and
(f) promote tax compliance and a culture of responsibility.

In Australia the current members of TJN-Aus are:

- ActionAid Australia
- Aid/Watch
- Australian Council for International Development (ACFID)
- Australian Council of Trade Unions (ACTU)
- Australian Education Union
- Anglican Overseas Aid
- Baptist World Aid
- Caritas Australia
- Columban Mission Institute, Centre for Peace Ecology and Justice
- Friends of the Earth
- Global Poverty Project
- Greenpeace Australia Pacific
- Jubilee Australia
- National Tertiary Education Union
- Oaktree Foundation
- Social Justice Around the Bay
- Social Policy Connections
- Synod of Victoria and Tasmania, Uniting Church in Australia
- TEAR Australia
- Union Aid Abroad – APHEDA
- UnitedVoice
- UnitingWorld
- Victorian Trades Hall Council
- World Vision Australia

Question 1

Views are sought on the extent to which another country not exercising its right to tax should be a matter of concern to Australia.

Australia should be deeply concerned about situations where another country fails to exercise its right to tax. This is a significant problem where Australia has a Double Tax Agreement (DTA) with the jurisdiction in question, as if the other jurisdiction is failing to exercise its right to tax creates a situation of having a DTA with an effective tax haven. This provides significant temption for MNEs to shift profit to the country that is failing to exercise its right to tax.

Secondly, jurisdictions that fail to exercise their right to tax are likely to undermine international efforts to address the problem of BEPS. If BEPS is not addressed in a multilateral way it will encourage countries to adopt unilateral responses and may erode an orderly international tax framework. As stated by the OECD: [4]

> *Because many BEPS strategies take advantage of the interface between the tax rules of different countries, it may be difficult for any single country, acting alone, to fully address the issue. Furthermore, unilateral and uncoordinated actions by governments responding in isolation could result in the risk of double – and possibly multiple – taxation for business. This would have a negative impact on investment, and thus on growth and employment globally. In this context, the major challenge is not only to identify appropriate responses, but also the mechanisms to implement them in a streamlined manner, in spite of the well-known existing legal constraints, such as the existence of more than 3,000 bilateral tax treaties. It is therefore essential that countries consider innovative approaches to implement comprehenisve solution.*

Thirdly, Australia has demonstrated its commitment to assisting developing countries in addressing poverty. This is best achieved if developing countries have sustainable resources of their own, to work towards eliminating the need for overseas aid. Australia assists developing countries to build their economies and trade capacities.[5] In the case of many developing countries it is not a matter of them choosing not to exercise their right to tax, but rather of not having the expertise and resources to investigate and take action against profit shifting activities of MNEs. Increasing the economy of a developing country in itself does not guarantee poverty reduction, a point made in the 2012 Economic Outlook report by the Asian Development Bank. Australia's aid program includes the objectives of "improving incomes, employment and enterprise opportunities for poor people" and "improving governance in developing countries to deliver services, improve security, and enhance justice and human rights for poor people".[6] To have any hope of fulfilling these aims it is necessary to ensure developing country governments are able to generate enough sustainable revenue for themselves (although this in itself is not a guarantee of fulfilling the goals as a governmment can still spend the revenue it raises poorly. However, there is no hope of achieving the goals if the government does not have adequate revenue to start with). The ATO provides assistance to developing countries to increase their capacity to collect adequate taxation and to combat tax evasion and tax avoidance. As outlined in these policies of other Departments, the Australian Government sees developing countries being able to participate more actively in the global economy as benefiting Australia, creating new markets for Australian exports. Thus it is Australia's interests that developing countries be able to exercise their right to tax.

---

[4] OECD, 'Addressing Base Erosion and Profit Shifting', OECD Publishing, http://dx.doi.org/10.1787/9789264192744-en, 2013, p. 8.

[5] http://www.dfat.gov.au/trade/trade_and_development/

[6] http://www.ausaid.gov.au/makediff/pages/aid-policy.aspx

Finally, when other jurisdictions facilitate tax evasion and tax avoidance through providing secrecy to foreign entities, through failure to implement the Financial Action Task Force recommendations on anti-money laundering and counter terrorism financing and through allowing the use of shell companies, they also risk facilitating other forms of transnational crime and the funding of terrorism.[7] This is not in Australia's interests and is linked to MNE tax dodging.

On the basis of the third reason, Australia's commitment to assist developing countries in addressing poverty, the TJN-Aus urges the Australia Government to give strong support to the OECD project 'Tax Inpsectors Without Borders' in both funding and in providing experts for the program. The OECD reports demand from developing countries for assistance in addessing tax avoidance and tax evsion is strong, with a number of requests already having been made.[8] The Tax Inspectors Without Borders initiative would facilitate the deployment of experienced tax audit experts on a demand-led basis to developing countries. The sharing of expertsie and experience would focus on the transfer of knowledge and skills through a real-time 'learning-by-doing' approach, working directly on current audits concerning international tax issues, and establishing general audit practices. There would be benefits to Australian tax officials that participated in the program, as argued by the OECD:[9]

> *Developing countries face significant challenges in building capacity to address international tax issues. Working closely with the local officials involved in meeting those challenges will provide the expert with a unique insight into those challenges faced by developing countries. Such experience can only be of benefit to the individual in developing their knowledge and a broader international tax perspective, which will also benefit their home administration post-deployment.*

[7] See for example Emile van der Does de Willebois, Emily Halter, Robert Harrison, Ji Won Park and Jason Sharman, "Puppet Masters. How the Corrupt Use Legal Structures to Hide Stolen Assets and What to Do About It", World Bank and UNODC, 2011.

[8] OECD Task Force on Tax and Development, 'Draft Final Report on the Feasibility Study into the Tax Inspectors Without Borders Initiative', 17 May 2013, p. 2.

[9] OECD Task Force on Tax and Development, 'Draft Final Report on the Feasibility Study into the Tax Inspectors Without Borders Initiative', 17 May 2013, p. 7.

Question 2

Views are sought on whether there is evidence of Base Erosion and Profit Shifting in Australia. Where it is considered that insufficient data exists to reach a definitive conclusion on the extent and nature of the problem in Australia, comments are sought on how to identify and/ or develop such data – including the benefits and costs of requiring companies to provide more detailed information to the ATO.

The TJN-Aus is concerned that the current level of confidentiality provided to MNEs by the *Taxation Administration Act 1953* makes assessment of profit shifting by MNEs operating in Australia very difficult, if not impossible, with only the ATO and the MNEs having access to the detailed information that would allow a thorough assessment to be made. However, even the ATO would be unable to make a detailed assessment of the extent of profit shifting taking place.

Profit shifting reduces the reportable profit of an MNE, so profit shifting is unlikely to show up in examining effective tax rates.

However, there are some examples of work that has been done indicating that MNEs operating in Australia are engaged in profit shifting. In 2009, Christian Aid commissioned international transfer pricing expert, Associate Professor Simon Pak, president of the Trade Research Institute and an academic at Penn State University in the US, to analyse EU and US trade data and estimate the amount of capital shifted from non-EU countries into the EU and the US through bilateral transfer mispricing. Professor Pak, who has advised US Congress on this issue, analysed bilateral trade in every product between 2005 and 2007, calculated the parameters of the normal price range for products traded between countries, and estimated the amount of capital shifted by trades that are outside that normal price range. He calculated Australia lost 1.1 billion euros in tax revenue through transfer mispricing to the EU in the period 2005 – 2007 and US$1.5 billion in tax revenue through transfer mispricing to the US in the same period.[10]

Work by Taylor and Richardson found that for publicly listed Australian companies thin capitalisation and transfer mispricing were the primary methods of tax avoidance in the period 2006 to 2009.[11] However, communication with Professor Rick Krever from the Department of Business Law and Taxation at Monash University points to the limitations of such work, due to the level of confidentiality that applies to the tax affairs of MNEs. As Professor Krever points out "In the absence of any actual data, Taylor and Richardson in effect tried to recreate the level of transfer pricing and offshore arrangements by looking at surrogate measurements, assuming there will be a correlation between different factors and the level of international income shifting." Thus, as with all regression analysis, assumptions must be made and the analysis is then made on the basis of the assumptions. Professor Krever went on to point out "the problem is that the underlying assumptions are pure guesses. We truly have no data to develop what we know are accurate assumptions. If we had that data, we wouldn't need to do the regression analysis to reconstruct the levels of avoidance – we'd simply add up the numbers." This is not critique of Taylor and Richardson's work, it simply points to the limitations imposed on all analysis of the level of profit shifting by MNEs in Australia due to the level of confidentiality provided to them by Australian law.

Professor Krever stated the only way to accurately estimate the level of profit shifting that is occurring:

---

[10] David McNair and Andrew Hogg, 'False profits: robbing the poor to keep the rich tax-free', Christian Aid, March 2009. pp.20, 27.

[11] Grantley Taylor and Grant Richardson, "International Corporate tax Avoidance Practices: Evidence from Australian Firms", The International Journal of Accounting **47**, (2012), p. 491.

is to adopt the formula used in formula apportionment systems and measure the relative sales to final consumers (unrelated parties), the payroll costs, and the tangible capital costs in each country and divide total world income using the formula. Once you've done that, you'll see how much income should have been reported in Australia. But once you've done that, you might as well tax using a formula apportionment system rather than the water's edge or arm's length fictions we now use and the problem goes away.

Work by Karkinsky and Riedel that examined European based MNEs found that the number of patents registered in a jurisdiction reduced with the tax rate for that jurisdiction. The effect prevails when they accounted for the role of withholding taxes on royalty payments and CFC legislations.[12] They concluded that MNEs do distort the location of their corporate patents in favour of low-tax affiliates. Further:[13]

As patented technologies are considered to be drivers of future profits and simultaneously constitute a major source of transfer pricing opportunities within multinational groups, their relocations are likely to shift relevant volumes of profit to low-tax economies. Consequently, governments have an incentive to compete for these mobile profits by reducing their corporate tax rates in order to attract multinational patents to their jurisdiction.

Based on their work, Treasury could examine the locations of patents held by MNEs based or operating in Australia as an indicator of risk of profit shifting. Further, a trend of shifting patent location over time to secrecy jurisdiction may be an indicator of increased likelihood of profit shifting activities based on royalty payments. However, this measure is only likely to be a very small part of any profit shifting activities taking place out of Australia.

[12] Tom Karkinsky and Nadine Riedel, 'Corporate taxation and the choice of patent location within multinational firms', J. International Economics, 88 (2012), p. 185.
[13] Tom Karkinsky and Nadine Riedel, 'Corporate taxation and the choice of patent location within multinational firms', J. International Economics, 88 (2012), p. 185.

Question 3

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 action?

The OECD has identified the following key pressure areas:[14]

- Increased transparency on effective tax rates of multinational enterprises (MNEs);
- International mismatches in entity and instrument characterisation including hybrid mismatch arrangements and arbitrage;
- Application of treaty concepts to profits derived from the delivery of digital goods and services;
- The tax treatment of related party debt-financing, captive insurance and other inter-group financial transactions;
- Transfer pricing, in particular in relation to the shifting of risks and intangibles, the artificial splitting of ownership of assets between legal entities within a group, and transactions between such entities that would rarely take place between independents;
- The effectiveness of anti-avoidance measures, in particular GAARs, CFC regimes, thin capitalisation rules and rules to prevent tax treaty abuse; and
- The availability of harmful preferential regimes.

The TJN-Aus agrees these are all important areas to be addressed.

3.1 Increased Transparency

The TJN-Aus is concerned about the level of confidentiality provided to multinational corporations under the *Taxation Administration Act 1953*, protecting such corporations from public scrutiny in regards to assessing the tax contribution these companies make and if there is a risk they are engaged in profit shifting activities. The TJN-Aus believes greater transparency around the tax affairs of MNEs is necessary to ensure the public are able to better understand the corporate tax system and engage in tax policy debates, as well as to discourage aggressive tax minimisation practices by large corporate entities.

3.1.1 Progress on Multinational Corporation Tax Transparency Globally

The TJN-Aus notes that Australia is now lagging behind both the US and the EU in measures of public transparency related to tax. The *US Dodd-Frank Wall Street Reform and Consumer Protection Act* requires companies in the oil, gas and mining sector listed on the US Securities and Exchange Commission to have to publicly report on taxes and royalties paid to governments on a country-by-country and project-by-project basis. On 9 April, the EU finalised negotiations to amend its Accounting and Transparency Directives, which will require EU-listed and large unlisted extractive industry and forestry companies to publicly publish the payments they make to governments on a country-by country and project-by-project basis.[15] The EU Directive will require disclosure of:

(a) Production entitlements;
(b) Taxes on production

[14] OECD, 'Addressing Base Erosion and Profit Shifting', OECD Publishing, http://dx.doi.org/10.1787/9789264192744-en, 2013, pp. 47-48.

[15] Council of the European Union, 'New transparency rules for the extractive industry and simplification of accounting requirements for companies', 17 April 2013, http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/intm/136824.pdf and Council of the European Union, 'Proposal for a Directive of the European Parliament and of the Council on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings (Accounting Directive) (First reading) - Approval of the final compromise text' 12 April 2013, http://register.consilium.europa.eu/pdf/en/13/st08/st08328.en13.pdf

(c) Royalties;
(d) Dividends;
(e) Signature, discovery and production bonuses;
(f) Licence fees, rental fees, entry fees and other considerations for licences and/or concessions; and
(g) Payments for infrastructure improvements.

It applies to all payments to governments in the over categories over €100,000. The EU Directive is provided in full in the Appendix to this submission.

The Extractive Industries Transparency Initiative, a voluntary scheme that aims to cut corruption in the natural resource sector, announced in February a new standard that will require all 37 of its implementing countries to report extractive industry revenues on a project-by-project basis in line with US and EU legislation. Tax and royalty payments will also be disclosed on a company-by-company basis.

The measures introduced by the US and the EU are steps towards reducing tax evasion and other forms of corruption by making it harder for companies to shift their revenues to secrecy jurisdictions unseen. It also increases the ability of citizens of developing countries to hold their own governments to account for the tax revenue they receive from natural resources. The extractives sector in developing countries has often been associated with grand levels of corruption and lost revenue for the ordinary people of the country.[16]

On 21 June 2012, the Norwegian Government announced it would introduce country-by-country reporting by the start of 2014.

Some corporations such as Talisman Energy, Statoil, Newmont Mining, Rio Tinto, Oil Search Limited, Resolute Mining, Paladin Energy, PanAust Limited, Newcrest Mining Limited and Anglogold Ashanti already disclose payments on a country-by-country basis.[17]

The EU has also moved towards a standard of country-by-country reporting for financial institutions[18], having negotiated rules stating:

1. *From 1st January 2015 Member States shall require institutions to disclose in their annual report, specifying by Member State and by third country in which it has operations, the following information on a consolidated basis for the financial year:*
    (a) Profit or loss before tax;
    (b) Tax on profit or loss;
    (c) Turnover
    (d) Number of employees
    (e) Public subsidies received.

    [2. The information referred to in paragraph 1, c) and d) shall be made public six months after entry into force of this directive as part of their annual report.]

    3. The information referred to in paragraph 1, a), b) and e), shall be submitted by all European G-SIIs and S-IIs institutions six months after entry into force of this Directive to the Commission. The Commission, in consultation with the relevant

---

[16] Reuters, 'Zambia to audit miners, believe up to $1 bln owed', http://af.reuters.com/articlePrint?articleId=AFL5E8D75SN20120207, 7 February 2012.

[17] Kathryn Martorana, 'Legislating Transparency in the Extractive Sector', Policy Innovations, 2011, CAER and Publish What You Pay Australia, 'Australia: An Unlevel Playing Field. Extractive industry transparency on the ASX200', May 2013, pp. 8 -11.

[18] 'MEPs cap bankers' bonuses and step up bank capital requirements', http://www.europarl.europa.eu/news/en/pressroom/content/20130225IPR06048/html/MEPs-cap-bankers'-bonuses-and-step-up-bank-capital-requirements

ESAs, shall conduct a general assessment as regards potential significant negative economic consequences of the public disclosure of this type of information, including impact on competitiveness, investment and credit availability and financial stability. The Commission shall submit its report to the Council and the European Parliament at the latest by 31 December 2014.

In the event that the Commission report identifies significant negative effects, it is invited to make a proposal for a modification of the scope and/or modalities of the reporting obligations laid down in paragraph 1. In such a situation the Commission shall be empowered to adopt a delegated act to defer the disclosure obligation laid down in paragraph 1. The Commission shall review every year the necessity to extend this deferral.

4. The report referred to in the first paragraph shall be audited in accordance with Directive 2006/43/EC of 17 May 2006 on statutory audits of annual accounts and consolidated accounts.

5. To the extent the reporting obligation laid down in paragraph 1 is provided for in future EU legislation beyond those laid down in this article, the obligation of this article shall cease to apply.

The EU negotiated rules on country-by-country reporting for financial institutions have wider scope than the rules on the extractive sector as they cover wherever the financial institution has an establishment, covering countries where the financial institution has a legal presence. The rules for country-by-country reporting for the extractives sector cover payments made in countries where the company has ‘activities’, such as exploration, extraction and development.

On 22 May the EU financial services chief, Michel Barnier, was quoted in the media as stating the EU will seek to extend the country-by-country reporting requirements that apply to financial institutions, as outlined above, to “all large companies operating in the European Union.”[19]

The UN Manual on Transfer Pricing already recommends that tax authorities require MNEs to provide worldwide consolidated accounts to facilitate effective implementation of transfer pricing audits.[20]

3.1.2 Tax Justice Network model of Multinational Corporate Transparency

The TJN believes that greater transparency of the activities of multinational corporations is what they should be required to provide in return for the licence they are granted to operate in each jurisdiction in which they are present. This licence to operate ring fences their risk in the country in question, makes it easier to differentiate their tax liabilities between territories (allowing them to avoid double taxation) and grants them limited liability within that jurisdiction.[21] The ability to limit liability, not just within the corporation as a whole, but within each element of it that is wrapped within its own, self-contained, but nevertheless commonly controlled subsidiary, is an extraordinary situation that has developed seemingly by accident rather than design. The privilege of limited liability reduces the cost of capital because societies around the world explicitly accept the risk that if, for any reason, a constituent of a

[19] Richard Murphy, ‘The rush to country-by-country reporting is on’, http://www.taxresearch.org.uk, 24 May 2013.

[20] ‘No more shifty business’, Civil Society response to the OECD’s Base Erosion and Profit Shifting report on tax.

[21] Richard Murphy, ‘Country-by-Country Reporting. Accounting for globalisation locally’, Tax Justice Network, 2012, p. 2.

multinational corporation ceases to trade then the company and the owners of its capital will not have to make good the loss incurred and that risk will instead be transferred to the state in which it traded and the members of the community who traded with it in that place.[22] Greater transparency is a reasonable price in return for the privilege of limited liability, as it puts on record the risk that a community is exposing itself to by hosting the activities of a multinational corporation. This is almost impossible to determine with regard to the activities of a multinational corporation without country-by-country reporting. While the accounts of a nationally based corporation (if on the public record) by definition show the risk arising within the jurisdiction in which it is based, the accounts of a subsidiary of a multinational corporation working in a jurisdiction do not allow an assessment of risk to be made as they do not show the risks present to the corporation as a whole.[23]

Most of the time the cost of the failures are contained within the business, banking and investment communities of each country as part of the collective risk they take. However, that is not always the case as the global financial crisis demonstrated. In many other parts of the world massive state bailouts were provided at the cost to the communities in those countries.

The current system of accounting for multinational companies recognises none of these risks.[24]

Country-by-country reporting, as outlined below, will allow the providers of capital to enjoy a better view of the risk they face, which should further reduce the cost of capital.[25] Country-by-country reporting is intended to have both macroeconomic and microeconomic benefits.

The TJN is concerned that in many countries a corporation does not have to put its accounts on the public record. A company cannot be accountable to its host community if it cannot be identified. For that to happen the names a multinational corporation uses locally must be on the public record. Too often they are not.

The TJN is concerned that existing multinational corporation accounts eliminate intra-group trading and transactions from public view. Revealing this information is vital if trade relationships are to be understood and made fair.

Many of the major corporate scandals of recent times have involved extensive use of offshore subsidiary companies. These are becoming increasingly common throughout the multinational corporate world. For example, examination of the 2010 annual reports of the ASX100 companies at that time found 61 of these companies had over 692 subsidiaries located in financial secrecy jurisdictions, where the financial secrecy jurisdiction had been calculated to have a secrecy score of 65 or greater in the 2011 Financial Secrecy Index.[26] The subsidiaries were located in 28 of the 52 financial secrecy jurisdictions with a secrecy score greater than 65. However, the TJN-Aus is aware from other research that not all companies in the ASX100 publish the full list of all their global subsidiaries in their Australian

[22] Richard Murphy, 'Country-by-Country Reporting. Accounting for globalisation locally', Tax Justice Network, 2012, pp. 2-3.
[23] Richard Murphy, 'Country-by-Country Reporting. Accounting for globalisation locally', Tax Justice Network, 2012, p. 4.
[24] Richard Murphy, 'Country-by-Country Reporting. Accounting for globalisation locally', Tax Justice Network, 2012, p. 3.
[25] Richard Murphy, 'Country-by-Country Reporting. Accounting for globalisation locally', Tax Justice Network, 2012, p. 4.
[26] Mark Zirnsak, 'Secrecy Jurisdictions, the ASX100 and Public Transparency', Uniting Church in Australia, Synod of Victoria and Tasmania, May 2013; and Tax Justice Network, 'The Methodology of the 2011 Financial Secrecy Index', September 2011.

annual report, so the number is a significant underestimate of the number of subsidiaries for the ASX100 located in financial secrecy jurisdictions. The extensive use of subsidiaries in financial secrecy jurisdictions results in increased risk for shareholders and others who need to understand the risk involved in the multinational company they are investing in or doing business with.

The EU negotiated rules on country-by-country reporting for financial institutions is much closer to the model the Tax Justice Network seeks. In the TJN model each multinational corporation would be required to disclose in its annual financial statements:[27]

- The name of each country in which it operates;
- The names or all its companies trading in each country in which it operates;
- What its financial performance is in every country in which it operates, without exception, including:
    - Its sales, both third party and with other group companies;
    - Purchases, split between third parties and intra-group transaction;
    - Its hedging transactions, both third party and intra-group;
    - Labour costs and employee numbers;
    - Financing costs split between those paid to third parties and to other group members;
    - Its pre-tax profit.
- The tax charge included in its accounts for the country in question;
- Details of the cost and net book value of its physical fixed assets located in each country including the cost of all investments (including those relating to exploration) made in assets related to extractive industries activity by location and the proceeds of sale from disposals of such assets by location;
- Details of its gross and net assets in total for each country in which it operates.

Tax information would need to be analysed by country in more depth requiring disclosure of the following for each country in which the corporation operates:

- The tax charge for each year split between current and deferred tax;
- The actual tax payments made to the government of the country in the period;
- The liabilities (and assets, if relevant) owing for tax and equivalent charges at the beginning and end of each accounting period;
- Deferred taxation liabilities for the country at the start and close of each accounting period.

For extractive companies, the TJN seeks a full breakdown of all the benefits paid to each government in which the multinational company operates broken down between the categories of reporting required in the Extractive Industries Transparency Initiative.

The TJN recognises that public advantages of country-by-country reporting will be limited in the case of small and medium sized companies, meaning it is reasonable to exclude such companies from the requirements of country-by-country reporting.[28]

As such, a full country-by-country reporting financial statement is required of multinational corporations for those jurisdictions where it is present and meets one of the following suggested criteria:[29]

---

[27] 'Research Briefing. Country-by-country reporting', Task Force for Financial Integrity and Economic Development, Tax Justice Network and Tax Research UK, October 2010 ; and Richard Murphy, 'Country-by-Country Reporting. Accounting for globalisation locally', Tax Justice Network, 2012, p. 8.

[28] Richard Murphy, 'Country-by-Country Reporting. Accounting for globalisation locally', Tax Justice Network, 2012, p. 6.

[29] Richard Murphy, 'Country-by-Country Reporting. Accounting for globalisation locally', Tax Justice Network, 2012, p. 19.

- Turnover plus hedging derivative and financial income in the jurisdiction exceeds $5 million in the reporting period;
- The net value of tangible fixed assets in the jurisdiction increases by more than $5 million in the reporting period;
- Turnover plus financial income in the jurisdiction exceeds 5% of the total consolidated turnover plus financial income of the reporting entity during the reporting period; or
- The jurisdiction is one in which upstream extractive industries activity occurs.

A financial *de-minimus* by country is specified because materiality for country-by-country reporting purposes must always be determined at the level of the country, not at the level of the reporting entity.

A more limited unaudited disclosure of information would be required for jurisdictions where the multinational company meets one of the following criteria:[30]

- Turnover plus hedging, derivative and financial income in the jurisdiction exceeds $1 million in a reporting period; or
- The net value of tangible fixed assets in the jurisdiction increases by more than $1 million in a reporting period.

In these cases the activities of the reporting entity may be material to the country for which disclosure is required, but that significance is not sufficient to require the additional cost of audit.

If the above conditions are not met, then only disclosure of a trading presence within the jurisdiction should be required, but no further financial disclosure. In such cases the activity of the reporting entity is likely to be immaterial to the host country itself and as such the cost of financial disclosure is not justified.

There are clear benefits for investors with greater disclosure. Disclose of the locations a multinational company is doing business in allows an investor to assess:[31]

- The degree of exposure to geopolitical risk that the company is likely to face, simply by presence in certain locations;
- The degree of reputational risk that the company might face as a consequence of its decision to trade in certain locations;
- The trends in the geographical spread of the company's activities over time, indicating diversity, or absence thereof; and
- Whether they wish to invest in corporations with assets in locations they do not wish to associate with, which is likely to be of importance to some ethical investors.

The publication of a profit and loss account for each jurisdiction allows investors to assess:[32]

- The risk that the internal supply chains create for the company, most especially for governance. The use of tax havens has frequently been association with governance failures leading in turn to corporate failure, as occurred with Enron and Parmalat as examples;
- The flow of finance charges within the group, and the particular impact these might have on an intragroup basis with regard to the reallocation of profits between jurisdictions, giving rise to risk of transfer pricing or thin capitalisation challenge from taxation authorities, prejudicing the potential quality of future earnings; and

[30] Richard Murphy, 'Country-by-Country Reporting. Accounting for globalisation locally', Tax Justice Network, 2012, p. 20.
[31] Richard Murphy, 'Country-by-Country Reporting. Accounting for globalisation locally', Tax Justice Network, 2012, p. 32.
[32] Richard Murphy, 'Country-by-Country Reporting. Accounting for globalisation locally', Tax Justice Network, 2012, pp. 33-34.

- The rate of return on capital employed by jurisdiction, suggesting whether or not assets are efficiently allocated by group management to the locations in which the company trades.

Business efficiency is dependent upon the availability of high quality information. Unless that information is available then sub-optimal decisions on everything from resource allocation within a company to capital allocation between companies will be inefficient at the cost to society as a whole. Country-by-country reporting may take away some of the advantages that the current opacity provides to certain multinational companies, but it is beneficial to business as a whole.[33]

Companies already have the information required for country-by-country reporting, as they need to be able to assess their tax liabilities in every country in which they operate. To not have this information would already mean that officers of the companies in question were committing offences under accounting laws.[34]

3.2 Transfer Pricing

The TJN-Aus remains concerned about the limitations of the 'arm's length' principle (ALP), especially transactional methods, and urges supporting other methods at a multilateral level to combat tax evasion through transfer mispricing. The OECD arm's length principle particularly has disadvantaged developing countries in combating tax evasion by multinational companies, as such countries often lack the resources to be able to investigate and prosecute multinational companies engaged in tax evasion through transfer mispricing based on the arm's length principle. In its most recent report on transfer pricing, TJN states 'In recent years many developing countries have introduced or strengthened arrangements for combating tax avoidance, including abusive transfer pricing. However, the vast majority of poor developing countries do not have the resources to apply the complex and time-consuming checks on transfer pricing demanded by the OECD approach. Even the largest among them, such as Brazil, China, India, and South Africa have experienced serious difficulties in applying the ALP, especially in finding suitable comparables.'[35] Brazil, China, India and South Africa are examples of countries which adopt approaches that diverge from those acceptable to OECD countries.

TJN-Aus is concerned that the current OECD guidelines are inadequate to address the problem of 'double non-taxation', where a multinational company is able to ensure a portion of its profits are untaxed by any jurisdiction.

The money lost by developing countries from transfer mispricing is vast. Anti-corruption non-government organisation, Global Financial Integrity, estimated collectively developing countries lost US$418 billion from transfer mispricing in 2009, much of this money laundered through secrecy jurisdictions. Africa lost US$25 billion in transfer mispricing, while the Philippines lost US$8.1 billion, Cambodia US$721 million and Indonesia US$8.5 billion.[36] Globally overseas aid in 2009 was only US$120 billion.

---

[33] Richard Murphy, 'Country-by-Country Reporting. Accounting for globalisation locally', Tax Justice Network, 2012, p. 56.
[34] Richard Murphy, 'Country-by-Country Reporting. Accounting for globalisation locally', Tax Justice Network, 2012, p. 57.
[35] Sol Picciotto, 'Towards Unitary Taxation of Transnational Corporations' Tax Justice Network, 14, http://www.taxjustice.net/cms/upload/pdf/Towards_Unitary_Taxation_1-1.pdf Last viewed 11 December 2012.
[36] Dev Kar and Sarah Freitas, 'Illicit Financial Flows from Developing Countries Over the Decade Ending 2009', Global Financial Integrity, December 2011, pp. 5, 48-50.

TJN believes that international corporate tax abuse means that many of the underpinning international principles are fundamentally flawed, with the most dominant example being the "separate entity" approach and the arm's length requirement under current transfer pricing rules. This is particularly evident in certain industries such as internet-based business and financial firms. Even the OECD itself recognises the problems of the current transfer pricing system. For example, the head of the OECD's Transfer Pricing Unit, Joseph Andrus, was quoted in the press as saying:

> *Whatever it is we are doing isn't producing accurate results if it turns out that 75% of the world's income, under a transfer pricing system, is reflected as being earned in Singapore, Switzerland, the Cayman Islands and Bermuda.*[37]

The OECD has requested that its members undertake a consultation process with business and civil society towards the development of an initial comprehensive action plan to address base erosion and profit shifting by multinational corporations. The plan will be presented to the Committee on Fiscal Affairs in June this year.[38] The action plan will include:[39]

> *Improvements or clarifications to transfer pricing rules to address specific areas where the current rules produce undesirable results from a policy perspective. The current work on intangibles, which is a particular area of concern, would be included in a broader reflection on transfer pricing rules.*

The OECD has accepted:[40]

> *There are a number of studies and data indicating that there is increased segregation between the location where actual business activities and investment take place and the location where the profits are reported for tax purposes. Actual business activities are generally identified through elements such as sales, workforce, payroll and fixed assets.*

There is great scope for misunderstanding or deliberate mispricing in areas around intellectual property such as patents, trademarks and other proprietary information within the arm's length principle. Multinational enterprises arise in large part due to organisational and internalisation advantages relative to the efforts of unrelated, separate companies that seek to do business with one another. Such advantages mean that within multinational enterprises, profit is generated in part by internalising transactions within the firm. Thus, for companies that are truly integrated across borders, holding related entities within the commonly controlled group to an 'arm's length' standard for pricing of intra-company transactions does not make sense, nor does allocating income and expenses on a country-by-country basis.[41] Simply, there is an air of artificiality in applying the arm's length standard to multinational companies.[42] As multinational companies gain a greater efficiency in transactions over unrelated firms[43], their costs will be lower and profits higher than

[37] Julie Martin, "OECD Moving Quickly With Base Erosion Project", 14 February 2013.

[38] OECD, 'Addressing Base Erosion and Profit Shifting', OECD Publishing, http://dx.doi.org/10.1787/9789264192744-en, 2013, p. 9.

[39] OECD, 'Addressing Base Erosion and Profit Shifting', OECD Publishing, http://dx.doi.org/10.1787/9789264192744-en, 2013, p. 10.

[40] OECD, 'Addressing Base Erosion and Profit Shifting', OECD Publishing, http://dx.doi.org/10.1787/9789264192744-en, 2013, p. 20.

[41] Reuven S. Avi-Yonah, 'Between Formulary Apportionment and the OECD Guidelines: A Proposal for Reconciliation', University of Michigan Law School, Paper 102, 2009.

[42] Kerrie Sadiq, 'The Traditional Rationale of the Arm's Length Approach to Transfer Pricing – Should the Separate Accounting Model be maintained for modern Multinational Entities?', J. Australian Taxation **7(2)**, (2004), p. 198; and Michael Durst, 'It's Not Just Academic: The OECD Should Reevaluate Transfer Pricing Laws', Tax Analysts, 18 January 2010.

[43] Kerrie Sadiq, 'The Traditional Rationale of the Arm's Length Approach to Transfer Pricing – Should the Separate Accounting Model be maintained for modern Multinational Entities?', J. Australian Taxation **7(2)**, (2004), pp. 237, 241; Michael Durst, 'It's Not Just Academic: The OECD Should

transactions between unrelated firms. This means the arm's length principle overestimates the costs of transactions for multinationals and, hence, underestimates their profits meaning a portion of the profit goes untaxed.

Reuvan Avi-Yonah (2009) argues the arm's length transfer pricing rules have spawned a huge industry of lawyers, accountants and economists whose professional role is to assist multinational companies in their transfer pricing planning and compliance. He concludes that no matter how assiduously one performs "functional analyses" designed to identify "uncontrolled comparables" that are reasonably similar to members of multinational groups, one is rarely going to find them. He argues such comparables have not been found with sufficient regularity to serve as the basis for a workable transfer pricing system based on the arm's length principle. The US General Accounting Office did a study in the early 1990s that indicated in over 90% of the cases the three traditional methods of Comparable Uncontrolled Price could not be applied because comparables could not be found.[44]

Michael Durst, a former director of the IRS advance pricing agreement, has stated that in 20 years of practice: "I have seldom, if ever, seen a real-life transfer pricing controversy resolved by anything that could reasonably be viewed as sufficiently close comparables."[45]

Reuvan Avi-Yonah points out in the US, the fact that neither taxpayers nor enforcement authorities typically have clear standards for judging compliance with the arms' length principle means that issues involving very large amounts – billions of dollars – of federal revenue are resolved in examination, settled in Appeals, resolved in negotiations under tax treaties with foreign governments, negotiated through advance pricing agreements, or settled by lawyers out-of-court after examination. In most cases, federal privacy law require that this decision-making occur outside of the public eye. The resolution of issues involving such large amounts of money, without the benefit of clearly discernible decision-making standards and public scrutiny, is not healthy for the tax system.[46]

Michael Durst has also argued:[47]

> *A second fundamental flaw in the arm's-length system, which has become increasingly evident over the past decade, is that by treating different affiliates within the same group as if they were free-standing entities, the system respects the results of written contracts between those related entities. These contracts have no real economic effects, as the same shareholders stand on both sides of them, but they nevertheless are given effect under the arm's-length standard.*
>
> *Thus, multinational groups generally have been free to enter into internal contracts that shift interests in valuable intangibles to tax haven countries in which taxpayers conduct little if any real business activity.*

There is growing concern amongst developing countries that Australia is a trading partner with that the OECD Guidelines on transfer pricing serve OECD member countries and do not address the concerns of developing countries.[48]

Reevaluate Transfer Pricing Laws', Tax Analysts, 18 January 2010; and Michael Durst, 'The Two Worlds of Transfer Pricing Policymaking', Tax Justice Network, 24 January 2011.

[44] Reuven S. Avi-Yonah, 'Between Formulary Apportionment and the OECD Guidelines: A Proposal for Reconciliation', University of Michigan Law School, Paper 102, 2009.

[45] Michael Durst, 'The Two Worlds of Transfer Pricing Policymaking', Tax Justice Network, 24 January 2011.

[46] Reuven S. Avi-Yonah, 'Between Formulary Apportionment and the OECD Guidelines: A Proposal for Reconciliation', University of Michigan Law School, Paper 102, 2009.

[47] Michael Durst, 'It's Not Just Academic: The OECD Should Reevaluate Transfer Pricing Laws', Tax Analysts, 18 January 2010.

China is Australia's largest trading partner, making up the source of 24.6% of Australia's exports and 19.9% of Australia's two-way trading.[49] While it has based its transfer pricing system on the OECD arm's length principle, its tax authorities express concern at the difficulty of finding comparables due to the limited amount of Chinese listed companies and lack of information sharing mechanisms among different administration authorities and different regions. Further, there are difficulties in making reasonable adjustments between Chinese companies and comparables located overseas.[50] Thus, Chinese tax authorities deviate from strict adherence to the OECD Guidelines and tend to analyse the profit of the tested party in the context of the whole supply chain. They seek to rationalise the appropriateness of allocations of Chinese companies' profits in the whole supply chain of multinational enterprises, unaffected by their related position.[51] Adjustments to company transactions are applied by the tax authorities to adjust for 'special' Chinese factors, such as location savings and market premiums.

Chinese authorities are also concerned about the growing use of intangibles by foreign companies. For example, Chinese tax authorities note the increase in royalties paid from companies operating in China to foreign companies from US$6 billion in 2006 to US$14.7 billion in 2011.[52]

To address the problems faced in implementing the OECD Guidelines, Chinese tax authorities plan to make greater use of the profit split method or hybrid methods to test whether or not the result reflects the reasonable allocation of profit from the whole supply chain.[53] There will also be greater emphasis on signing more Advance Pricing Agreements (APAs).

The number of transfer pricing adjustments carried out by Chinese tax authorities in recent years is shown in Table 1. While the number of cases involved has remained relatively the same each year, the amount of transfer pricing adjustments collected have been dramatically increasing.

Table 1. Chinese transfer pricing adjustments.[54]

Year	Number of transfer pricing adjustments	Total adjustment (RMB billions)	Total adjustment (A$ millions)
2006	177	0.46	70
2007	174	0.68	103
2008	152	1.00	152
2009	167	1.24	188
2010	178	2.09	317
2011	207	2.58	392

---

48 Anita Kapur, Director General of Income Tax (Administration), "Indian Transfer Pricing System", 13 May 2012, http://www.taxjustice.net/cms/upload/pdf/Anita_Kapur_1206_Helsinki_ppt.pdf

49 Australia Department of Foreign Affairs and Trade, "Australia's Trade in Goods and Services by Top Ten Partners, 2011", 15 May 2012, http://www.dfat.gov.au/publications/tgs/Australias-goods-services-by-top-10-partners-2011.pdf.

50 Zhang Ying, State Administration of Taxation of People's Republic of China, "China's transfer pricing system", 13 May 2012.

51 Zhang Ying, State Administration of Taxation of People's Republic of China, "China's transfer pricing system", 13 May 2012.

52 Zhang Ying, State Administration of Taxation of People's Republic of China, "China's transfer pricing system", 13 May 2012.

53 Zhang Ying, State Administration of Taxation of People's Republic of China, "China's transfer pricing system", 13 May 2012.

54 Zhang Ying, State Administration of Taxation of People's Republic of China, "China's transfer pricing system", 13 May 2012.

Global Financial Integrity have calculated the losses to China from tax evasion are enormous. They have calculated trade misinvoicing-adjusted gross illicit outflows from China increased from US$172.6 billion in 2000 to US$602.9 billion in 2011. This is a 7.2% growth rate per annum, which is slightly below the 10.2% average annual growth rate of GDP over this period.[55] In 2011, trade misinvoicing was calculated to be 5.9% of Chinese GDP.[56] Misinvoiced trade between Chinese companies and the US increased from an estimated US$48.8 billion in 2000 to US$59 billion in 2011.[57]

India is Australia's fourth largest designation of exports, making up 5.6% of all exports from Australia and 3.3% of all two way trade.[58] India does not apply a hierarchy of transfer pricing methods under the OECD guidelines.[59] So the transaction based methods do not take precedent over the profit splitting method contained within the OECD Guidelines.

As shown in Table 2, India's attempts to deal with transfer mispricing involve massive efforts with an ever growing number of adjustments needing to be applied to businesses.

Table 2. Indian transfer pricing adjustments[60]

Financial Year	Number of transfer pricing audits completed	Number of cases involving adjustment	% of cases involving adjustment	Amount of adjustment (in INR billion)	Amount of adjustment (in A$ billion)
2008-2009	1726	670	39	61.4	1.1
2009-2010	1830	813	44	109.1	1.9
2010-2011	2301	1138	49	232.4	4.1
2011-2012	2638	1343	52	445.3	7.8

TJN is of the view that an alternative system of unitary taxation would bring the international system into closer alignment with economic reality, and hence greatly improve its effectiveness and legitimacy.[61] There is particular concern that the arm's length principle applies poorly to more modern types of businesses and that unitary taxation is a viable alternative to industries such as internet based businesses and multinational financial institutions.[62]

---

[55] Dev Kar and Sarah Freitas, "Illicit Financial Flows from China and the Role of Trade Misinvoicing", Global Financial Integrity, October 2012, p. 4.
[56] Dev Kar and Sarah Freitas, "Illicit Financial Flows from China and the Role of Trade Misinvoicing", Global Financial Integrity, October 2012, p. 5.
[57] Dev Kar and Sarah Freitas, "Illicit Financial Flows from China and the Role of Trade Misinvoicing", Global Financial Integrity, October 2012, p. iv.
[58] Australia Department of Foreign Affairs and Trade, "Australia's Trade in Goods and Services by Top Ten Partners, 2011", 15 May 2012, http://www.dfat.gov.au/publications/tgs/Australias-goods-services-by-top-10-partners-2011.pdf.
[59] Anita Kapur, Director General of Income Tax (Administration), "Indian Transfer Pricing System", 13 May 2012, http://www.taxjustice.net/cms/upload/pdf/Anita_Kapur_1206_Helsinki_ppt.pdf
[60] Anita Kapur, Director General of Income Tax (Administration), "Indian Transfer Pricing System", 13 May 2012, http://www.taxjustice.net/cms/upload/pdf/Anita_Kapur_1206_Helsinki_ppt.pdf
[61] Sol Picciotto, 'Towards Unitary Taxation of Transnational Corporations' Tax Justice Network, 10, http://www.taxjustice.net/cms/upload/pdf/Towards_Unitary_Taxation_1-1.pdf Last viewed 11 December 2012.
[62] Sol Picciotto, 'Towards Unitary Taxation of Transnational Corporations' Tax Justice Network, 16, http://www.taxjustice.net/cms/upload/pdf/Towards_Unitary_Taxation_1-1.pdf Last viewed 11 December 2012.

The TJN-Aus believes the Australian Government should support the development of a new international norm to eventually replace the OECD arm's length principle using combined reporting, with formulary apportionment and Unitary Taxation.[63] This would prioritise the economic substance of a multinational and its transactions, instead of prioritising the legal form in which a multinational organises itself and its transactions.

3.2.1 An Alternative System

The TJN-Aus believes the Australian Government should support the development of a new international norm to eventually replace the OECD arm's length principle using combined reporting, with formulary apportionment and Unitary Taxation.[64] This would prioritise the economic substance of a multinational and its transactions, instead of prioritising the legal form in which a multinational organises itself and its transactions. Australia is well placed to further consideration of such a new norm as the incoming chair of the G20 in 2014.

Unitary taxation originated in the US over a century ago, as a response to the difficulties US states were having in taxing railroads. Over 20 states inside the US, notably California, have set up a system where they treat a corporate group as a unit, then the corporate group's income is "apportioned" out to the different states according to an agreed formula. Then each state can apply its own state income tax rate to whatever portion of the overall unit's income was apportioned to it. Such a formula allocates profits to a jurisdiction based upon real factors such as total third-party sales; total employment (either calculated by headcount or by salaries) and the value of physical assets actually located in each territory where the multinational operates. The Tax Justice Network recognises there are technical and political complexities involved in designing such an "apportionment" formula. However, limited forms of unitary taxation have been shown to work well in practice.

The aim of unitary taxation is to tax portions of a multinational company's income without reference to how that enterprise is organised internally. Multinational companies would have far less need to set themselves up as highly complex, tax-driven multi-jurisdictional structures and are likely to simplify their corporate structures, creating efficiencies. The big losers are those consultants who derive substantial income from setting up and servicing complex tax-driven corporate structures. By using worldwide rather than origin-based income, formulary apportionment eliminates any need for geographic income and expenses accounting. In doing so, it largely eliminates the possibility of transfer price manipulation and several other tax avoidance techniques created by tax rate variation between geographic jurisdictions.[65]

The solution of unitary taxation 'fits the economic reality that TNCs are usually oligopolies based on distinctive or unique technology or know-how: they exist because of the advantages and synergies that come from combining economic activities on a large scale and in different locations. These advantages cannot be attributed to a single location, but to

---

[63] Tax Justice Network, 'Transfer Pricing', http://www.taxjustice.net/cms/front_content.php?idcat=139; and The Hamilton Project, 'Reforming Corporate Taxation in a Global Economy: A Proposal to Adopt Formulary Apportionment', The Brookings Institute, Policy Brief No. 2007-08, June 2007.

[64] Tax Justice Network, 'Transfer Pricing', http://www.taxjustice.net/cms/front_content.php?idcat=139; and The Hamilton Project, 'Reforming Corporate Taxation in a Global Economy: A Proposal to Adopt Formulary Apportionment', The Brookings Institute, Policy Brief No. 2007-08, June 2007 and Sol Picciotto, 'Towards Unitary Taxation of Transnational Corporations' Tax Justice Network, http://www.taxjustice.net/cms/upload/pdf/Towards_Unitary_Taxation_1-1.pdf Last viewed 11 December 2012.

[65] 'Reforming Corporate Taxation in a Global Economy: A Proposal to Adopt Formulary Apportionment', The Hamilton Project, The Brookings Institute, Washington USA, Policy Brief No. 2007-08, June 2007, p. 3.

the whole global entity. Treating each affiliate as a separate entity for tax purposes is impractical and does not correspond to economic reality.'[66]

TJN views unitary taxation as a superior model and in its most recent report states:

> '*Unitary taxation would greatly reduce opportunities for international tax avoidance due to profit-shifting and the use of tax havens. By simplifying tax administration, it would cut the costs of compliance for firms and would benefit poor developing countries especially. TNCs also provide powerful political cover for many tax havens: by curbing their use unitary taxation would make it politically far easier to tackle tax havens on financial secrecy and many other issues. And by aligning tax rules more closely to economic reality it would improve the fairness and transparency of international tax and help create a level playing field for business.*'[67]

TJN-Aus believes that unitary taxation is a superior model for taxing multinational entities. Despite some obvious transitional problems, TJN believes that the time is now right for reform.[68] Hybrid versions of the arm's length and unitary taxation system are possible as interim steps.[69] TJN-Aus believes that managed transition through serious studies, the adoption of Unitary Taxation by groups of countries (eg, the EU) or the introduction of unitary taxation within the present system are all viable and attainable methods of bringing about a system which fits with economic reality and reduces the opportunity for tax avoidance through profit shifting.[70]

3.3 Automatic Information Exchange between Tax Authorities

The TJN-Aus supports the growing global trend towards requiring automatic exchange of tax related information between tax authorities as a measure to stem tax evasion through shifting income offshore. The TJN-Aus sees the move towards automatic information exchange between tax authorities, with appropriate safeguards on the privacy of the information and against its misuse, as highly desirable. The OECD recently endorsed automatic information exchange as proving "to be a useful way to implement enhanced international tax co-operation".[71] The OECD has outlined the benefits of automatic information exchange as:[72]

> *"It can provide timely information on non-compliance where tax has been evaded either on an investment return or the underlying capital sum. It can help detect cases of non-compliance even where tax administrations have no previous indications of non-compliance. Other benefits include its deterrent effects, increasing voluntary compliance and encouraging taxpayers to report all relevant information. Automatic exchange may also help educate taxpayers in their reporting obligations, increase tax*

---

[66] Sol Picciotto, 'Towards Unitary Taxation of Transnational Corporations' Tax Justice Network, 1, http://www.taxjustice.net/cms/upload/pdf/Towards_Unitary_Taxation_1-1.pdf Last viewed 11 December 2012.

[67] Sol Picciotto, 'Towards Unitary Taxation of Transnational Corporations' Tax Justice Network, 1, http://www.taxjustice.net/cms/upload/pdf/Towards_Unitary_Taxation_1-1.pdf Last viewed 11 December 2012.

[68] Sol Picciotto, 'Towards Unitary Taxation of Transnational Corporations' Tax Justice Network, 1, http://www.taxjustice.net/cms/upload/pdf/Towards_Unitary_Taxation_1-1.pdf Last viewed 11 December 2012.

[69] Reuven S. Avi-Yonah, 'Between Formulary Apportionment and the OECD Guidelines: A Proposal for Reconciliation', University of Michigan Law School, Paper 102, 2009.

[70] For a discussion on these options see Sol Picciotto, 'Towards Unitary Taxation of Transnational Corporations' Tax Justice Network, 14-16, http://www.taxjustice.net/cms/upload/pdf/Towards_Unitary_Taxation_1-1.pdf Last viewed 11 December 2012.

[71] OECD, "Tackling Offshore Tax Evasion. The G20/ OECD Continues to make progress", June 2012, p. 2.

[72] OECD, "Tackling Offshore Tax Evasion. The G20/ OECD Continues to make progress", June 2012, p. 4.

revenues and thus lead to fairness – ensuring that all taxpayers pay their fair share of tax in the right place at the right time."

Further, "automatic exchange as a tool to counter offshore non-compliance has a number of benefits. It can provide timely information on non-compliance where tax has been evaded either on an investment return or the underlying capital sum."

The OECD reports the EU experience with the Savings Directive suggests that in the absence of automatic information exchange in excess of 75% of taxpayers may not have complied with their residence country tax obligations.[73] Further examples were provided by the OECD with regards to foreign source income:[74]

- In 2009, Norway received automatic information exchange from a number of its treaty partners. Files above a certain threshold were verified against the returns of income filed by taxpayers in Norway. Results of the investigation disclosed that in 38.7% of the cases income which was taxable in Norway had not been reported.
- Under a special project, Denmark used information received automatically to conduct 1,000 audits, resulting in additional tax revenue. In addition, 1,100 letters were sent out to other taxpayers with the information that the Danish Tax Administration received on foreign income. This resulted in 440 persons reporting foreign income in their tax return which they had not reported in previous years.

The OECD report stated "Results of a recent survey on automatic information exchange conducted by the OECD show widespread use of automatic exchange of information regarding country coverage and income types, transaction values and records exchanged." They found that eight countries had sent more than one million records in a particular year. The US sent 2.5 million records in a particular year. Thirty-one countries combined sent 17.8 million records in a particular year. However, few developing or emerging economy countries were amongst those currently benefiting from automatic information exchange, with those listed being China, India, Mexico and South Africa.[75]

The OECD stated that it "stands ready to develop a multilateral platform to facilitate that practice [automatic information exchange] for countries interested in joining the Convention."[76] The Convention being referred to is the Multilateral *Convention on Mutual Administrative Assistance on Tax Matters.*

As an example of the limitations of information exchange on request, France released data on its tax information exchange requests in January 2013. The data showed that of 230 requests made in the first eight months of 2011, they received only 71 replies by the end of 2012.[77]

In the 19 June 2012 G20 Leaders Declaration made in Los Cabos they stated:[78]

We welcome the OECD report on the practice of automatic information exchange, where we will continue to lead by example in implementing this practice. We call on countries to join this growing practice as appropriate and strongly encourage all jurisdictions to sign the Multilateral Convention on Mutual Administrative Assistance.

---

[73] OECD, "Tackling Offshore Tax Evasion. The G20/ OECD Continues to make progress", June 2012, p. 18.

[74] OECD, "Tackling Offshore Tax Evasion. The G20/ OECD Continues to make progress", June 2012, p. 18.

[75] OECD, "Tackling Offshore Tax Evasion. The G20/ OECD Continues to make progress", June 2012, p. 16.

[76] OECD, "Tackling Offshore Tax Evasion. The G20/ OECD Continues to make progress", June 2012.

[77] E-mail from by Emeritus Professor Sol Picciotto from Lancaster University, 2 February 2013.

[78] http://www.whitehouse.gov/the-press-office/2012/06/19/g20-leaders-declaration

As of 26 October 2012, a total of 53 countries had signed the *Convention on Mutual Administrative Assistance in Tax Matters*, including a number of developing countries.[79] The OECD expects this to increase to more than 60 countries after the third signing ceremony on 29 May 2013. However, the OECD notes not many "offshore jurisdictions have so far joined the Convention and further support of the G20 may be useful in this regard."[80]

The communique of the April 2013 meeting of the G20 Finance Ministers called for automatic information exchange to become the new global norm between treaty partners:

> *14. More needs to be done to address the issues of international tax avoidance and evasion, in particular through tax havens, as well as non-cooperative jurisdictions. We welcome the Global Forum's report on the effectiveness of information exchange. We commend the progress made by many jurisdictions, but urge all jurisdictions to quickly implement the recommendations made, in particular the 14 jurisdictions, where the legal framework fails to comply with the standard. Moreover, we are looking forward to overall ratings to be allocated by year end to jurisdictions reviewed on their effective practice of information exchange and monitoring to be made on a continuous basis. In view of the next G20 Summit, we also strongly encourage all jurisdictions to sign or express interest in signing the Multilateral Convention on Mutual Administrative Assistance in Tax Matters and call on the OECD to report on progress. We welcome progress made towards automatic exchange of information which is expected to be the standard and urge all jurisdictions to move towards exchanging information automatically with their treaty partners, as appropriate. We look forward to the OECD working with G20 countries to report back on the progress in developing of a new multilateral standard on automatic exchange of information, taking into account country-specific characteristics. The Global Forum will be in charge of monitoring. We welcome the progress made in the development of an action plan on tax base erosion and profit shifting by the OECD and look forward to a comprehensive proposal and a substantial discussion at our next meeting in July.*

India has previously publicly called for this to become the new global norm of dealing with combating tax evasion. The Indian Central Board of Direct Taxes manual on exchange of information states:

> *Government is making efforts both at bilateral levels and on global forums to make the exchange of information on automatic basis as part of the global standards….*
>
> *India has taken a lead in making the automatic exchange of information as standards so that all countries start exchanging the information available with them regarding taxpayers of other countries voluntarily and on automatic basis.*

The Indian Government has estimated there is $500 billion of funds from Indians that have been illicitly shifted to secrecy jurisdictions, including Mauritius, Switzerland, Liechtenstein and the British Virgin Islands.[81]

The US is using their *Foreign Account Tax Compliance Act* (FATCA) to leverage automatic information exchange. A growing number of intergovernmental agreements with the US over FATCA will encourage an increasing number of financial institutions to accept automatic information exchange. As an increasing number of countries participate in the FATCA system, the viable offshore investment opportunities for tax evaders globally will diminish.[82]

---

[79] OECD Secretary-General Report to the G20 Finance Ministers, 2013, p. 35.
[80] OECD Secretary-General Report to the G20 Finance Ministers, 2013, p. 35.
[81] Tax Justice Network, 15 February 2012, http://taxjustice.blogspot.com.au/2012/02/senior-indian-official-lashes-out.html
[82] J. Richard Harvey Jr., "Offshore Accounts: Insider's Summary of FATCA and Its Potential Future", Villanova Public Law and Legal Theory Working Paper Series, December 2011, p. 24.

France, Germany, Italy, Spain and the UK have entered into a pilot initiative to extend the range of information they automatically exchange.[83]

The Irish Minister for Finance, Michael Noonan, and the Commissioner of the European Commission, have called for an:[84]

> *Agreement that automatic exchange of information involving a broader range of income and capital payments should be our objective, and that work at EU level should begin without delay on devising the specifics of such broader exchange, building on international developments of recent years.*

As an example of the growing acceptance of automatic information exchange, the British Bankers Association stated to the US Treasury in 2010:[85]

> *"the longer term, we urge the US and other nations to work towards an alternative global multilateral solution, where there would be reciprocal arrangements for all jurisdictions, and where information could be collected and exchanged between governments. We propose that consideration of a multilateral solution be an agenda item for upcoming meetings of the G20 since this is clearly an issue of international concern that requires a coordinated response."*

Even some secrecy jurisdictions are starting to give in to pressure to implement some level of automatic information exchange. For example, Luxembourg has announced it will provide automatic information exchange for EU citizens from 1 January 2015. However, it will not apply to foreign companies operating in Luxembourg.[86]

The OECD has also published a guide on ensuring the protection of taxpayer information, entitled "Keeping it Safe: the OECD Guide on the Protection of Confidentiality of Information Exchange for Tax Purposes".[87] The OECD is working to offer, to all interested countries, a multilateral platform for effective standardized automatic information exchange:[88]

> *Working with partner countries (including Argentina, Brazil, China, India, the Russian Federation and South Africa), the OECD is advancing rapidly in the development of a common model for reporting and automatic exchange of certain account information held by financial institutions, including due diligence rules, reporting formats and secure transmission methods. The goal is to maximise compliance benefits for residence countries, reduce costs for financial institutions and contain all necessary safeguards through the development of one standard (rather than a proliferation of different ones).*

The legal basis for automatic information exchange is the exchange of information provision of a double taxation convention based on Article 26 of the OECD or UN Model Convention or Article 6 of the *Convention on Mutual Administrative Assistance in Tax Matters.*[89]

---

[83] Michael Noonan, Irish Minister for Finance and Algirdas Semeta, Commissioner, European Commission, Letter to EU Finance Ministers, 29 April 2013.
[84] Michael Noonan, Irish Minister for Finance and Algirdas Semeta, Commissioner, European Commission, Letter to EU Finance Ministers, 29 April 2013.
[85] British Bankers Association, "Comments for Notice 2010-60", 29 October 2010, http://www.bsmlegal.com/PDFs/FATCA_BBA_20101029.pdf.
[86] Michele Sinner, 'Luxembourg announces end of bank secrecy with EU states', Trust Law, http://www.trust.org/, 10 April 2013.
[87] OECD, "Tackling Offshore Tax Evasion. The G20/ OECD Continues to make progress", June 2012, pp. 3-4.
[88] OECD Secretary-General Report to the G20 Finance Ministers, 2013, p. 36.
[89] OECD, "Tackling Offshore Tax Evasion. The G20/ OECD Continues to make progress", June 2012, p. 14.

Australia already requires financial institutions to have to report interest payments on accounts held by non-residents, although the financial institution is not required to obtain a Tax Identification Number (TIN) or date of birth of the non-resident.

The TJN-Aus notes that Australia already provides information on tax related matters to over 40 countries and receives information automatically from 20 countries. Australia sent more than one million records in a particular year.[90]

It is disappointing that developing countries, that often feel the greatest negative impacts from tax evasion, have had only limited access to initiatives involving automatic information exchange.

3.3.1 Measures to encourage Automatic Information Exchange

Given that some jurisdictions have made a deliberate choice to act as secrecy jurisdictions and facilitate tax dodging and profit shifting the MNEs, Australia should implement measures that seek to penalise such jurisdictions to encourage them to comply with automatic information exchange and other global standards addressing money laundering, tax avoidance and tax evasion. Such measures should include:

- Disallowing deductions or credits with respect to transactions with residents of a jurisdiction that does not effectively exchange information (which is already used by Argentina, Brazil, Germany, India and Italy);
- Applying higher rates of withholding taxes on all transfers of funds to jurisdictions that do not engage in effective information exchange (which is already used by Argentina, France, Mexico and the Slovak Republic);
- Deeming funds received from a secrecy jurisdiction that does not provide automatic information exchange to be assessable income; and
- The application of administrative measures which discourage companies from using non-co-operative jurisdictions, such as reversing the burden of proof, higher audit requirements and requiring records to be kept for 20 years rather than the standard five years for records involving the use of secrecy jurisdictions that do not commit to automatic information exchange).

3.4 Disclosure of Ultimate Beneficial Owner

The OECD has provided data on the use of special purpose entities (SPEs) through jurisdictions that have assisted in profit shifting by multinational companies. In general terms, SPEs are entities with no or few employees, little or no physical presence in the host economy, whose assets and liabilities represent investments in or from other countries, and whose core business consists of group financing or holding activities.[91] The TJN-Aus is concerned about the prevalence of SPEs in structures that use transfer mispricing to shift profits to secrecy jurisdictions. This is made worse when the owners of the SPE cannot be readily identified.

The TJN-Aus seeks that Australia introduce a requirement for a public register of the ultimate beneficial owners of companies, given the role shell companies and special purpose entities play in both tax dodging and many forms of illicit flows.[92] It should also support this becoming a global standard. Research by Findley, Nielson and Sharman also found Australian corporate service providers were near the top of corporate service providers in terms of

---

[90] OECD, "Tackling Offshore Tax Evasion. The G20/ OECD Continues to make progress", June 2012, pp.16-17.

[91] OECD, 'Addressing Base Erosion and Profit Shifting', OECD Publishing, http://dx.doi.org/10.1787/9789264192744-en, 2013, p. 18.

[92] Global Witness, 'Undue Diligence. How banks do business with corrupt regimes', March 2009, pp. 109-111.

being willing to set up an untraceable shell company even when there was significant risk the company in question would be used for illicit purposes.[93]

The TJN-Aus notes the statement from the meeting of the G20 Finance Ministers and Central Bank Governors in Washington on 18-19 April 2013 that:

> *We must tackle the risks raised by opacity of legal persons and legal arrangements, and encourage all countries to take measures to ensure they meet the FATF standards regarding the identification of the beneficial owners of legal persons, other corporate vehicles and trusts, that is also relevant for tax purposes.*

A public register of the ultimate beneficial owners of companies would be a significant step in addressing the risks raised by opacity of shell companies.

3.5 Private Sector Whistleblower Protection

Whistleblowers in the private sector in other jurisdictions have played a valuable role in exposing cases of tax evasion (and other fraud against government). The OECD Working Group on Bribery *Phase 3 Report on Implementing the OECD Anti-Bribery Convention in Australia* released in October 2012 found Australia provided inadequate protection to whistleblowers in the private sector:

> *144. Regarding private sector whistleblowers, laws cited by the Australian authorities are insufficient or irrelevant to foreign bribery. Section 317A of the Corporations Act protects officers, employees and contractors of Australian companies who disclose violations of the Corporations Act to ASIC. This covers disclosure of foreign bribery-related false accounting, but not foreign bribery per se. Whistleblower laws that apply only to financial institutions are not so restricted and cover disclosures about any misconduct, including foreign bribery. None of these laws, however, protects disclosures to law enforcement or the media….*

The Working Group highlighted the value of whistleblower protection in combating foreign bribery, but this would be equally applicable to disclosures of tax evasion and tax avoidance:

> *145. Despite inadequate protection, some whistleblowing does occur. Some participants at the on-site visit believed that whistleblowing in the private sector has been useful in detecting misconduct such as foreign bribery. In the Securency/NPA case, one whistleblower reported wrongdoing to the company and the AFP, while a second disclosed allegations to the media. The case, however, may also highlight the need to better protect whistleblowers, as two Securency employees claim to have been dismissed after raising bribery concerns. Commentators believe that better whistleblower protection could lead to a higher level of foreign bribery enforcement.*

The OECD Working Group on Bribery recommended:

> … *Australia put in place appropriate additional measures to protect public and private sector employees who report suspected foreign bribery to competent authorities in good faith and on reasonable ground from discriminatory or disciplinary action.*

Since 1863 the US has also had the *False Claims Act* which has encouraged whistleblowers to come forward with information about fraud against the government in return for a share of the damages recovered. The *False Claims Act* empowers citizens to bring suit on behalf of

[93] Michael Findley, Daniel Nielson and Jason Sharman, 'Global Shell Games: Testing Money Launderers' and Terrorist Financiers' Access to Shell Companies', Centre for Governance and Public Policy, Griffith University, 2012, p. 21.

the government for fraud against the government.[94] The Act rewards the whistleblower 15% to 25% of the fraud recovered due to the whistleblowing.[95]

The provision of financial reward for whistleblowing has allowed the US to expose major cases of illegal activity against the US Government. Between 1986 and 2008 the amount of recovery from fraud was more than US$20 billion, and fraud has been detected at 50 times the rate before the amendments to the *False Claims Act* were made in 1986.[96] Last year the US Internal Revenue Service paid former banker Bradley Birkenfeld US$104 million for his role in exposing the role Swiss bank UBS had played in US citizens engaging in tax evasion. According to the IRS, Birkenfeld had “provided information on taxpayer behaviour that the IRS had been unable to detect, provided exceptional cooperation, identified connections between parties to transactions, and the information led to substantial changes in UBS business practices and commitment to future compliance.” They went on to say “While the IRS was aware of tax compliance issues related to secret bank accounts in Switzerland and elsewhere, the information provided by the whistleblower formed the basis for unprecedented actions against UBS.” His information directly resulted in UBS having to pay a US$780 million fine to the US Government and over 35,000 taxpayers voluntarily repatriated their illegal offshore accounts. This resulted in the collection of over US$5 billion in back taxes, fines and penalties. His disclosure also indirectly lead to revised tax treaty negotiations between the US and Swiss governments, and to UBS subsequently releasing the names of over 4,900 US taxpayers with offshore accounts, who were then investigated.[97]

A 2007 study of corporate fraud in the US between 1996 and 2004 by Alexander Dyck, Adair Morse and Luigi Zingales found only 6% of frauds were uncovered by the SEC and 14% by auditors. By comparison 19% were exposed by employees and 14% by the media.[98]

Media sources have reported as part of the Stop International Tax Evasion Program by the Canadian Revenue Agency, whistleblowers will be rewarded up to 15% of federal tax collected for information leading to tax recoveries exceeding $100,000.[99] The rewards will only be paid where the questionable activity involves foreign property, or property located or transferred outside Canada, or transactions conducted partially or entirely outside Canada. However, reward payments will be subject to income tax.

Germany also provides rewards for whistleblowing on tax evasion.[100]

Dr Mark Zirnsak
Secretariat
Tax Justice Network Australia
c/- 130 Little Collins Street
Melbourne, Victoria, 3000
Phone: (03) 9251 5265
E-mail: mark.zirnsak@victas.uca.org.au

---

[94] Indira Carr, “The UK Bribery Act: Business Integrity and Whistleblowers”, *Financial Fraud Law Report* 4(4), April 2012, pp. 368-369.
[95] Kim Sawyer, “Rewarding whistleblowers for risk brings results”, *The Australian Financial Review,* 23 December 2008.
[96] Kim Sawyer, “Rewarding whistleblowers for risk brings results”, *The Australian Financial Review,* 23 December 2008.
[97] Lowtax Library Newswire, “IRS Pays UBS Whistleblower USD104 m’, 14 September 2012.
[98] Kim Sawyer, “Rewarding whistleblowers for risk brings results”, *The Australian Financial Review,* 23 December 2008.
[99] Jason Fekete, “Whistleblowers will get cash rewards for helping nab tax cheats”, *Montreal Gazette,* http://www.montrealgazette.com, 21 March 2013.
[100] Jason Fekete, “Whistleblowers will get cash rewards for helping nab tax cheats”, *Montreal Gazette,* http://www.montrealgazette.com, 21 March 2013.

Acknowledgement: The TJN-Aus would like to acknowledge the contribution of Professor Kerrie Sadiq, School of Accountancy, Queensland University of Technology to the transfer pricing section of this submission.