BCA

Business Council of Australia

Submission to the multinational tax integrity and transparency consultation

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Overview

The Business Council of Australia (BCA) welcomes the opportunity to provide a submission to the consultation on proposed changes to deliver on the Government's election commitments on multinational tax integrity and transparency.

All companies must meet their tax obligations and where arrangements do not keep pace with community norms, they should be reviewed. Robust tax integrity and transparency measures are an integral complement to more competitive business tax arrangements.

Australia has some of the strongest tax integrity rules in the world, and they have been strengthened over time.[1] Existing integrity measures, institutions and enforcement all contribute towards and complement a high level of compliance with our tax system. The Australian Taxation Office (ATO) is a strong, capable, active and well-resourced administrator, with extensive powers and a strict interest and penalty regime. The ATO workforce focused on large companies is "larger and more skilled than it has ever been", and it has one-to-one engagement with large companies for assurance over approximately two-thirds of all corporate tax (around $60 billion).[2]

The BCA supports the notion that measures be balanced against "the need to attract and retain foreign capital and investment in Australia, limit potential additional compliance cost considerations for business, and continue to support genuine commercial activity." A consultation process that follows best practice principles is critical.[3]

The tax system must ensure that the Australian economy, which is heavily reliant on trade and foreign investment, remains strong and continues to grow. Productivity growth is a key priority for the Government's Jobs and Skills Summit. Investment is critical for driving productivity and has accounted for two-thirds of labour productivity growth the past 40 years. This includes through procurement of state-of-the-art machinery and equipment and the development and adoption of cutting-edge technologies.

The proposed changes are likely to increase the cost of doing business in Australia and follow the recent doubling of Foreign Investment Review Board fees. It is therefore critical to maintain a competitive business environment overall, while signalling to investors that Australia is open for business.

Key recommendations

1. Any proposed changes should be subject to a comprehensive assessment that follows best practice principles. This includes the problem to be solved must be well understood, new regulation is subject to cost–benefit analysis, and regulation must achieve its objectives at least cost.
2. Changes to thin capitalisation rules should consider indefinite carry forward of denied interest deductions to balance the objectives of meeting the policy intent, attracting and retaining foreign investment in Australia, minimising compliance costs and supporting genuine commercial activity.
3. If a proposal to deny deductions for intangible and royalty payments to low or no tax jurisdictions is pursued, the problem to be solved must be clearly identified alongside why existing laws may not adequately address the problem, and a targeted solution that continues to support genuine commercial activity.
4. Tax transparency disclosures should be guided by a set of principles that ensure stakeholders are better informed, commercial confidentiality is maintained and compliance costs are minimised.
5. The BCA endorses the Corporate Tax Association submission lodged in response to the consultation paper.

[1] Commonwealth of Australia, Treasury, *The Digital Economy and Australia's Corporate Tax System*, Treasury Discussion Paper, October 2018.
[2] https://www.ato.gov.au/General/Tax-and-Corporate-Australia/We-are-an-active-and-capable-administrator/, https://www.ato.gov.au/about-ato/research-and-statistics/in-detail/tax-gap/large-corporate-groups-income-tax-gap/
[3] Commonwealth of Australia, Department of the Prime Minister and Cabinet, *The Australian Government Guide to Regulatory Impact Analysis*

Additional information

Interest limitation rules

Australia's thin capitalisation regime is an integrity measure designed to ensure that multinationals do not allocate an excessive amount of debt to their Australian operations. They limit the extent to which a company may claim deductions for interest paid on debt.

Some business models require companies to fund operations with larger amounts of debt, in which case an arm's length debt test applies, to ensure they are not disadvantaged. There are many examples of businesses with significant upfront investments that take time to recoup and rely on high levels of debt. They include mines, oil and gas projects, infrastructure, power plants, aircraft and office buildings.

Earnings-based safe harbour test

The proposal to replace the safe harbour debt amount with an earnings-based safe harbour test must be mindful of the impact on capital intensive projects with long lead times (e.g. resources and infrastructure), start-ups and projects with volatile earnings. When combined with Australia's relatively high 30 per cent corporate tax rate, an approach that permanently denies interest deductions may adversely impact investment and represent one of the most onerous regimes in the world. At the same time, any changes that require companies to consider restructuring their debt must recognise this can be an expensive and lengthy process – while also raising questions around the need for transitional rules.

On balance, an interest limitation rule with indefinite carry forward of denied interest deductions would achieve the policy intent of the proposal while balancing the objectives of attracting and retaining foreign investment in Australia, minimising compliance costs and supporting genuine commercial activity. The ability to carry forward unused interest deductions is also a common feature adopted by most countries with an Earnings Before Interest, Taxes, Depreciation and Amortisation (EBTIDA) test.

Arm's length debt test

A move to an EBITDA test may see greater reliance on the arm's length debt test. This involves a detailed assessment of a company's debt to show that the borrowing can be supported on an arm's length basis and is commercially justifiable.

Greater reliance on the arm's length debt test will inevitably result in higher compliance and administration costs overall. It may be timely to consider the recommendations of the 2014 Board of Taxation *Review of the Thin Capitalisation Arm's Length Debt Test*, including whether an updated review may be warranted. The 2014 review concluded that the test "is an important integrity measure within the thin capitalisation rules" and that improvements could be made to "reduce compliance costs and relieve the administrative burden for taxpayers and the ATO".[4]

Other issues

The BCA supports the retention of the existing thin capitalisation exemptions for low-risk entities, including the de minimis threshold and exemption for outbound investors with 90 per cent of assets held in Australia.[5] The de minimis threshold was last increased in 2014 and could be updated to a more internationally comparable level.

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[4] Board of Taxation, *Review of the Thin Capitalisation Arm's Length Debt Test* (2014).
[5] Section 820-37, *Income Tax Assessment Act 1997*

Denying deductions for intangible and royalty payments to low or no tax jurisdictions

This section of the consultation paper outlines several integrity issues and concludes "Australia's existing integrity rules, including the transfer pricing rules and general anti-avoidance provisions go some way to tackling these issues. However, Australia's tax framework needs a specific measure targeting integrity issues associated with intangibles and royalties."

The consultation paper arguably does not make a clear case for introducing a specific measure to address these issues – particularly where they are already addressed by Australia's existing integrity rules. The consultation process must clearly identify the problem to be solved, establish why existing laws may not adequately address the problem and identify a targeted solution that continues to support genuine commercial activity.

The definition of a 'low or no tax jurisdiction' is critical to the application of any proposal. The approach used should not include countries that do not typically meet this definition, such as the United States and United Kingdom. For example, Australia's controlled foreign company rules include an exemption list.[6]

Tax transparency

The BCA strongly believes all companies and individuals must meet their tax and legal obligations, and will continue to actively encourage member companies to adopt the Tax Transparency Code.

The BCA has previously proposed that tax transparency disclosures be guided by a set of principles. This ensures stakeholders are better informed, commercial confidentiality is maintained and compliance costs are minimised. These principles are relevant in the context of the consultation paper and include:

- The information provided should be meaningful and better inform the public. This information can be both qualitative and quantitative in nature.
- Compliance costs should be minimised.
- There should be scope for flexibility in how firms provide tax transparency disclosures, such as in how the information is presented, recognising there is no 'one size fits all' approach.
- There should be consistency between domestic and international transparency and reporting measures. This includes clear equivalence provisions between jurisdictions to minimise the reporting burden and costs for companies operating in multiple jurisdictions.

The consultation paper notes an ideal "that the more information and data insights the wider community has on MNE structures and their cross-border activity, the more informed the debate will be about what level of tax should be paid by MNEs." This must be accompanied by a balanced assessment of the amount of tax paid by large companies, tax gaps and ATO analysis of the tax performance of large companies. For example, the ATO notes that "based on our detailed knowledge of the system as it operates in practice, most large corporate groups pay the right amount of tax."

There continues to be a reciprocal obligation on those analysing tax data and engaging in the tax debate to be rigorous and to understand the operational elements that underpin and explain a company's tax affairs, including the distinction between tax and accounting treatments. Misinterpretation and misrepresentation of facts can unnecessarily undermine the community's confidence in the integrity of our tax system and distort any debate.

The consultation paper notes that accessing tax information requires navigation across a variety of information sources to understand an entity's tax position. This is because different disclosures achieve different purposes. Even if disclosures were published in one location, it would still be inherently complex to understand a company's tax affairs – particularly where company supply chains or operations are disaggregated across the

[6] *Income Tax Assessment (1936 Act) Regulation 2015*

globe. Additional company reporting will also not necessarily enhance the ATO's ability to enforce our tax laws, given its already powerful information-collecting abilities.

The proposed start date for any disclosures must allow time for the necessary changes to systems and administrative processes – particularly for the initial reporting period. It will also require a lead time for the compilation of data and auditing. Given the proposed start date for the other measures in the consultation paper, alongside implementation of the OECD's two-pillar solution, additional time should be provided to comply.

Country-by-country reporting

The EU standards for country-by-country reporting provide a suitable template from which to consider a similar approach in Australia, including for implementation timelines. These have been through rigorous consultation and can deliver on the original policy intent to publish tax paid and employment data by jurisdiction, while minimising compliance costs for companies.

Any additional reporting should provide companies with flexibility around publication, for example within financial statements or as a standalone publication. This provides companies with an opportunity to explain and contextualise their tax affairs and maximises the utility of the information for users. At the same time, this approach would minimise compliance costs and balance the commitment to confidentiality of country-by-country reports under BEPS Action Item 13.

Reporting of material tax risk

The purpose of this proposal is "to assist shareholders to better understand their investments and any tax structuring arrangements of the company they are investing in." The consultation paper does not identify how or why existing disclosure requirements are inadequate in achieving this policy purpose e.g. IFRIC 23 – Uncertainty over Income Tax Treatments. The ATO also notes that "accounting standards on disclosure of uncertain tax positions have also been strengthened. This means companies must estimate their exposure on all matters it is probable we will dispute."[7]

The concept of 'material tax risk' is not defined, with the original policy announcement flagging mandatory reporting of tax havens exposure to shareholders.[8] The consultation paper also considers an alternative approach of taxpayers identifying to investors if they are a 'high-risk taxpayer' in line with certain Practical Compliance Guidelines.

Practical Compliance Guidelines "provide broad law administration guidance, addressing the practical implications of tax laws and outlining our administrative approach."[9] Disclosure of risk under various Practical Compliance Guidelines are unlikely to assist shareholders to "better understand their investments and any tax structuring arrangements" without the expertise to understand the context of the guidance or recognition of materiality. Materiality concepts are critical for preparing disclosures. This recognises the appropriateness of disclosure based on the size of each business, while balancing compliance costs and utility to users.

Other comments

The consultation paper follows on from the Government's election commitment platform to introduce a range of multinational tax integrity and tax transparency measures. However, some of the details and proposals in the consultation paper go beyond the scope of election commitments.[10]

The BCA strongly supports the commitment to "consult further on exposure draft legislation prior to introducing any legislation into Parliament." It is critical that consultation allows sufficient time to understand the potential

[7] https://www.ato.gov.au/General/Tax-and-Corporate-Australia/Public-information/
[8] https://www.alp.org.au/policies/labors-plan-to-ensure-multinationals-pay-their-fair-share-of-tax
[9] https://www.ato.gov.au/General/ATO-advice-and-guidance/ATO-guidance-products/Practical-compliance-guidelines/
[10] https://www.alp.org.au/policies/labors-plan-to-ensure-multinationals-pay-their-fair-share-of-tax

impact of any proposed changes, and ensures proposals meet the policy intent in a way that minimises compliance costs and avoids unintended consequences.

Any proposed multinational tax measures should apply no earlier than the first income year commencing from 1 July 2023. This reflects both the likely complexity of proposals, need to update existing systems and processes, limited time for consultation and implementation, and concurrent reforms, such as implementation of the OECD's two-pillar solution to address the tax challenges arising from the digitalisation of the economy.

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