Multinational Tax Integrity and Tax Transparency Consultation

Australian Government

The Treasury

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Guthrie, J. and Lucas, A. (August 2022), Commentary on the consultation paper by The Treasury Multinational Tax Integrity and Tax Transparency.

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Consultancy Preamble:

"The Government, as part of its election commitment platform, announced a multinational tax integrity package to address the tax avoidance practices of multinational enterprises (MNEs) and improve transparency through better public reporting of MNEs' tax information. These changes form part of the government's commitment to ensuring that MNEs pay their fair share of tax in Australia to help fund vital services, repair the Budget and level the playing field for Australian businesses."

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Preamble

The consultation paper prepared by **The Treasury's Multinational Tax Integrity and Tax Transparency** dated August 2022[i] provides a range of policy issues to address the tax avoidance practices of multinational enterprises (MNEs) and transparency issues regarding tax information. This commentary on the consultation paper was prepared with the aim of pointing out important omissions in that paper and making a range of recommendations for reform. These recommendations are informed by our expertise from studying the accounting practices of MNEs and the political economy of the fossil fuel industry.

The Australian Treasury paper provides some examples of accounting and tax planning practices used to minimise or even eliminate the amount of corporate tax paid by MNEs in the Australian context. Many of these practices have been in place for decades, including:

1. thin capitalisation rules required for the establishment and operation of corporations
2. corporations claiming payments for intangibles and royalties
3. corporations using accrual accounting techniques to minimise tax rates on profits
4. corporations shifting income to tax havens
5. corporate entities located in one jurisdiction lending money at a higher interest rate to subsidiary entities operating in other jurisdictions.

The OECD's latest gambit to reduce multinationals' tax avoidance relies on using accounting figures for tax reporting under a historic two-pillar plan. This is also the preferred opinion of the current Australian Government.

The OECD BEPS 2.0 move is expected to reallocate more than US$125 billion (A$180 billion) in profits from about 100 of the world's largest and most profitable multinationals to governments worldwide.[ii]

The focus of the Australian Treasury discussion paper is on the use of accounting figures for determining taxation. We agree that greater transparency, tighter regulation, and stricter enforcement of existing public disclosure provisions will improve the willingness of MNEs to pay appropriate levels of tax to the nation states in which they operate. However, neither the current nor the proposed tax accounting system is sufficient to the necessary task of requiring MNEs to pay appropriate levels of taxation relative to the revenue they generate in Australia.

Corporate tax and income tax

It is widely understood that different percentages of income tax are paid by individuals according to their levels of income within a fixed period. Corporate tax is not levied on income earned but on the net profitability of a particular corporate entity, which can be minimized using a wide range of deductions not available to individual taxpayers.

There are important differences between corporate tax and income tax. Corporate tax is a direct tax levied by the government on the net profits of corporations or analogous legal entities based on their income less deductions for wage, capital and other expenditures, whereas income tax is a tax imposed by government on an individual's income or profits, such as wages and salaries. The range of legitimate deductions available for different business and industry sectors is far greater than for individuals.

Tax avoidance and super profits

One of the most significant areas in which MNEs have exercised influence over government regulation is with regards to national and sub-national tax systems. That influence has enabled a range of tax avoidance measures that cost the Australian Government billions of dollars of tax revenue it could otherwise use for a wide range of useful social purposes.

A growing body of international research has documented how MNE's and wealthy individuals engineer the law and regulatory structures to their advantage. Elected officials routinely support legislation that advantages the interests of business and industry over that of the general public.[iii] The primary means by which business and industrial elites gain and maintain their influence over political and bureaucratic elites are through lobbying, political donations, and revolving door appointments between government and industry.[iv] Necessary prerequisites for minimizing undue corporate influence are a government bureaucracy transparent to democratic scrutiny and elected officials who are prevented from forming self-interested relationships with business and industry. In the absence of wide-ranging integrity reforms, more piecemeal approaches focused on tax reform would go some way to redressing the current imbalances and improprieties in how tax is levied on MNEs.

On 10 December 2021, the Australian Taxation Office (ATO) published the Corporate Tax Transparency Report (CTTR) for the 2019-2020 income year. The report, published each year using income tax and petroleum resource rent tax data, stands out as one of the more transparent measures for tax payments. Recent EU developments show that other jurisdictions are introducing mandatory tax information published country-by-country.

The ATO is legally required to publish certain tax entity information in the CTTR for entities, including:

- Australian public and foreign-owned entities with total income of $100 million* or more
- Australian-owned resident private entities with total income of $200 million or more
- Entities that have petroleum resource rent tax (PRRT) payable

However, this disclosure does nothing more than highlight the lack of tax paid by MNEs. Various commentators, including the respected financial journalist Michael West, highlight the lack of tax paid on the huge income received.[v]

Table 1 compiled by Market Forces was published earlier this year using publicly available ATO data as part of a broader report on the fossil fuel industry. Australia's top ten fossil fuel companies earned about $250 billion over the seven years to FY 2020 and paid no income tax. In total, 'the oil and gas industry in Australia paid **$1.7 billion of income tax** in 2018/19 (the most recent year for which data is available) on **$110 billion of income** (approx. 1.5 percent),' the report says.[vi]

Table 1: The polluting companies not paying their fair share of tax

(Market Forces 2022)

Company	Total income	Tax paid
ExxonMobil Australia	$71.2 billion	$0
Chevron Australia Holdings	$39.9 billion	$0
Australia Pacific LNG	$24.8 billion	$0
Peabody Australia	$24.0 billion	$0
QGC Upstream (Shell)	$21.9 billion	$0
Yancoal Australia	$21.6 billion	$0
Chevron Australia Products	$19.1 billion	$0
ENGIE Australian Energy	$11.1 billion	$0
Conocophillips Australia Gas Holdings	$10.6 billion	$0
CNOOC Gas & Power (Aus) Investment	$7.8 billion	$0

Total income and tax paid, seven years to FY2020

Over the last decade or so, there has been a growing awareness among Australians that multinational fossil fuel cartels are engaging in widespread tax avoidance while making super profits from public resources that belong to all Australians. Their ability to avoid paying income tax has been enabled by government legislation that: a) permits corporations to establish offshore tax havens into which they can funnel revenue, b) allows foreign-owned and located corporations to engage in transfer pricing to their Australian subsidiaries, and c) encourages the grandfathering of tax losses for an indefinite period.

The indefinite grandfathering of tax losses to offset new profits until those losses have been 'used up' is an anomalous concession provided to corporations by the Australian taxation system. It is the most generous rule on this issue of any OECD country, and has empowered fossil fuel MNEs to avoid paying billions of dollars in income tax. Limits should be imposed on all such losses informed by overseas best practice. This would have the positive outcome of discouraging high risk, highly capitalized enterprises which now characterize most fossil fuel development, while ensuring that enterprises with high revenues soon after establishment pay income tax commensurate with their earnings.

RECOMMENDATION 1

In order to minimize tax losses to the Australian Government due to activities relating to corporations shifting income to tax havens, as well as the practice of corporate entities located in foreign jurisdictions lending money or providing goods and services at a higher interest rate or price to subsidiary entities operating in Australia (i.e. 'transfer pricing'), sufficient resources within The Treasury should be allocated on an ongoing basis to examine and implement policies and regulations for minimizing or eliminating these practices.

RECOMMENDATION 2

All tax losses incurred by corporate entities should only be claimable for a certain amount of time after those losses were incurred, informed by best practice in other jurisdictions. The amount of time allowed could be varied by industry, depending on the capital expenditure required to establish relevant operations and normal expectations of returns based on historical evidence. Limits on the proportions of expenditure claimed or exemptions could also be imposed on environmentally and socially unsustainable business and industrial practices to discourage investment in them.

Tax transparency

The Treasury paper discusses enhancing tax transparency rather than focusing on why these companies pay no income tax in Australia. The Treasury canvassed a number of strategies to improve tax transparency in its paper, including:

- public reporting of tax information on a country-by-country basis,
- mandatory reporting of material tax risks to shareholders, and
- requiring companies bidding on tenders for Australian government contracts to disclose their country of domicile.

In considering the range of options available to The Treasury in the field of tax transparency, there is a veritable smorgasbord of government and private setting standards and guidelines. These include:

- reporting standards, e.g. GRI 207
- relevant rating agencies' ratings, e.g. S&P Global's Sustainability Index
- principle-based standards, e.g. Future Fit
- business-led initiatives, e.g. B-Team principles;
- the World Economic Forum's Stakeholder Capitalism Metrics
- the expectations of NGOs, e.g. Fair Tax Mark
- voluntary schemes, e.g. the Australian Tax Office (ATO) Tax Transparency Code or the Extractive Industries Transparency Initiative
- existing regulations, e.g. the EU's Capital Requirements Directive IV & the EU's public country-by-country directive.[vii]

RECOMMENDATION 3

We recommend implementation of the new GRI tax transparency standard, i.e. GRI 207: Tax. Launched in 2019, the GRI Tax Standard is the first and only global standard for the public, country-by-country reporting on tax, alongside tax strategy and governance. This is global and comes from three decades of GRI environment social and governance standard-setting.

RECOMMENDATION 4

The Corporate Tax Transparency Report (CTTR) that contains the total income, taxable income and tax payable of 2,370 corporate tax entities for the 2019-20 year should include in its entity definitions private equity firms and other entities held in trust in offshore locations.

The role of the 'Big Four' accountancy firms in enabling tax avoidance

The current state of external auditing practices and the dominant role in the auditing of major corporations played by the Big Four partnerships is a global issue, not just a national problem. Fossil fuel companies and other MNEs would be unable to pursue the accounting and legal practices associated with tax avoidance without the services of the Big Four accounting and tax planning partnerships. Without global solutions and regulation in the audit space, we will continue to observe significant conflicts of interest and avoidable risks to the financial sector which adversely affect the Australian economy and people by depriving the government of significant revenue to which it is lawfully entitled.

It is a sorry indictment of the ethical standards of major MNEs that what they have in common with garden-variety organized crime gangs is the professions of their willing accomplices, i.e. highly paid lawyers and accountants who beaver away at exploiting legal and regulatory loopholes in order to escape obeying the spirit and letter of the law while they simultaneously pretend that dark grey is sparkling white.[viii]

There is a yawning gap between Big Four marketing materials promoting integrity, transparency and community commitment and the aggressive and risky tax advice their partners provide. Recently, the Big Four partnerships and their social licence to operate across various areas, including taxation advice, have been investigated. For example, the *Sydney Morning Herald*, *The Guardian* and the *Australian Financial Review* have published a number of investigations into dubious practices concerning the conduct of the Big Four, as has the former finance editor for NewsCorp and Fairfax, Michael West. These investigations raise serious questions about whether the Big Four have fulfilled their social contract to operate as both auditors and management consultants.[ix]

The Second Commissioner of Taxation, Jeremy Hirschhorn, identified the reputational risk faced by these firms when some partners operate as though tax payment is discretionary. He pointed out that the Big Four partnerships may face systemic risk at a broad level if or when their licence to operate across a range of areas is questioned.

In terms of revenue growth and partnership profits, the lax ethical culture of these partnerships places these firms at risk. The Second Commissioner indicated that the research and development incentives scheme, aggressive transfer pricing, hiding behind legal privilege and not providing correct information to an ATO audit are high-risk strategies that draw attention to the Big Four's social licences to operate. He points to the Big Four's social duty to be held publicly accountable for ensuring that the large corporations which they invariably represent are paying the right amount of tax under the current laws.

These private partnerships have been instrumental in expanding the notion of audit and advisory and, consequently, their income streams. From an original mandate to audit company financial accounts, they now provide a range of consultancy services across a large variety of areas to government, business and industry, including universities. This now includes tax and accounting advice, as well as policy advice on risk, logistics, legal issues, human resources, outsourcing, compliance, marketing, reputation management, technological investment, and performance improvement.

RECOMMENDATION 5

The Parliament of Australia should investigate conflicts of interest and dubious ethical practices by the 'Big Four' accounting partnerships and those legal practices that provide taxation advice. These entities enable MNEs to avoid paying taxes. Such an enquiry would review the social licence and the social contract of the individuals and entities that provide taxation advice.

Global tax havens

While the implementation of more robust tax transparency measures may well be effective to some extent, The Treasury continues to prefer a model of corporate self-reporting of tax issues, rather than examining in any robust manner why some MNEs and other businesses are not paying appropriate (or any) taxes to the Australian Government. This is an extremely significant omission from a tax revenue perspective and therefore requires remedy.

A recent publication by the Tax Justice Network, Public Services International and the Global Alliance for Tax Justice (2020) estimates **USD427 billion in tax is lost to nation states every year from international corporate tax abuse**.[x] This consists of USD245 billion lost to tax abuse by MNEs and USD182 billion lost to private tax evasion. The same report found MNEs have shifted at least USD1.38 trillion worth of profits out of the countries where they were generated and into tax havens, roughly equivalent to Australia's annual GDP. Financial assets worth over USD10 trillion have been shifted offshore by private tax evaders.

What is of most concern is that the greatest enablers of global tax abuse are 'the rich countries at the heart of the global economy and their dependencies' Just four countries, i.e. the United Kingdom and its 'independent' territory of the Cayman Islands, the United States, Netherlands and Luxembourg, account for 47 percent of countries' tax losses, whereas lower income countries are responsible for only 2 percent. The annual amounts of tax they are estimated to cost global governments are recorded in **Table 2**

TABLE 2: Developed countries primarily responsible for global tax losses

Jurisdiction	**Responsible percentage of global tax loss**	**Annual tax loss (USD)**
British Territory Cayman	16.5	<70 billion
United Kingdom	10	<42 billion
Netherlands	8.5	<36 billion
Luxembourg	6.5	<27 billion
United States	5.53	<23 billion
TOTALS	**47.03**	**<198 billion**

Source: https://www.globaltaxjustice.org/en/latest/427-billion-lost-tax-havens-every-year

RECOMMENDATION 6

Because the UK, US, Netherlands and Luxembourg are responsible for almost half of annual global tax losses, Australia should open (or continue) discussions with these countries regarding increased reporting obligations and the disclosures required of companies registered in any tax exempt or protected territories within their jurisdictions.

Taxing corporate revenue

The incoming Labor Federal Government has a historic opportunity to engage in major reform of the corporate tax system. Rather than the current or proposed tax accounting system, we recommend that a simple 15% of revenue earned in Australia on sales be the corporate tax. Not only would this generate billions of dollars in revenue for government expenditure on education, health and other important portfolios, it would free up for more productive uses hundreds of millions of dollars in fees currently received by the 'Big Four' accounting partnerships and lawyers specialising in tax shifting and avoidance.

The idea of taxing 15% of all revenue earned within a single jurisdiction is not new, as there was a proposal presented to US Congress a few years ago to bring in a minimum tax based on 15% of pre-tax book income.[xi] Predictably, the proposal received pushback from accounting and tax experts. Simplifying calculations of tax to be paid would decrease the time spent performing such work and associated revenue streams. Corporate accounting and tax consulting is a multi-billion-dollar industry that would lose significantly from such a move.[xii]

We submit that regardless of the self-interested protestations of those corporations and consultancies that benefit from the existing situation, current forms of tax and financial accounting consist largely of 'smoke and mirrors' that serve to obscure rather than illuminate the earnings and tax obligations of corporate entities.

RECOMMENDATION 7

Corporate self-reporting is an insufficient policy to ensure adequate and lawful compliance. Standard forms of national disclosure should be required of the top companies, regardless of where they are domiciled. This statistical information should be collected by the Australian Taxation Office and placed on its website for public scrutiny.

RECOMMENDATION 8

In order to minimize opportunities for corporate profit shifting and other tax avoidance practices of dubious ethical or legal merit, a simple 15% of income earned in Australia should be the corporate tax on sales or revenues of multinationals and local enterprises. This would be a cash accounting rather than a historically derived tax accounting or an accrual accounting number.

ENDNOTES

i Australian Treasury (2022), Consultation paper by The Treasury Multinational Tax Integrity and Tax Transparency, Australian Government, Canberra.

ii Cooper, C. (2022), 'Crackdown on Profit Shifting', *In The Black,* CPAA, 35-38.

iii Gilens, M. and B.I. Page (2014), 'Testing theories of American politics: elites, interest groups, and average citizens', *Perspectives on Politics*, 12 (3), 564–581.

iv Lucas, A. (2021), 'Investigating networks of corporate influence on government decision-making: The case of Australia's climate change and energy policies', *Energy Research and Social Science*, 81: 102271: https://www.sciencedirect.com/science/article/abs/pii/S2214629621003649?via%3Dihub

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vi https://reneweconomy.com.au/gas-giants-paying-zero-income-tax-on-australian-operations-new-data-shows/

vii https://www.internationaltaxreview.com/article/2a6aafin5m44msdqmt2io/esg-tax-transparency-the-businesses-journey

viii https://thenewdaily.com.au/finance/2022/08/03/tax-rort-professions-michael-pascoe/; https://www.smh.com.au/politics/federal/global-gas-giants-use-loophole-to-avoid-tax-on-billions-from-australian-operations-20170425-gvrwn9.html

ix Various *Australian Financial Review* references on the Big Four:

1. How Deloitte, EY, KPMG and PwC partners minimise their tax bill
2. Allegations made against two KPMG partners
3. PwC reveals partners average tax rate with starting pay of 350k
4. The Fixer in a fix over EY move
5. Former KPMG, Deloitte, PwC tax partners join forces at Numara
6. Want to be more productive? Get up earlier, much earlier
7. Court actions against Deloitte, EY, KPMG and PwC
8. PwCs golden goodbye ties former partners to the firms profits forever
9. Some Big 4 partners are disrupting the tax system, the ATO tells estimates
10. The Big 4 consulting firms probed by ACCC over cartel conduct

x Global Alliance for Tax Justice (2020), '$427 billion lost to tax havens every year', 20 November, accessed 14 December 2021 at https://www.globaltaxjustice.org/en/latest/427-billion-lost-tax-havens-every-year

xi Cooper, C. (2022), 'Crackdown on Profit Shifting', *In The Black*, CPAA, 38.

xii Ibid.