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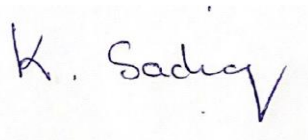
Submission in response to the public country-by-country reporting exposure draft legislation and accompanying explanatory materials, February 2024

We refer to the release of 12 February 2024 by the Treasury of the revised exposure draft legislation and accompanying explanatory materials implementing the public country-by-country reporting transparency measure.

In response to the Treasury's call for contributions and input, we attach a submission that addresses the revised nature of the draft legislation.

Kind regards,



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Submission in response to the public country-by-country reporting exposure draft legislation and accompanying explanatory materials, February 2024

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1. Overview

The introduction of public country-by-country reporting (CbCR) for large MNEs operating in Australia is an important step towards greater transparency of the tax arrangements of MNEs operating in Australia. Given that the proposed measures will ensure public availability of this information to all stakeholders in the Australian tax system, there is the potential for greater diversity in tax thinking and an increase in morally grounded views on taxation. Consistent with our submission to the original exposure draft legislation and accompanying explanatory materials for the introduction of public country-by-country reporting (CbCR), we believe that mandatory public reporting should go beyond the release of CbCRs. (see submission of 27 April 2023).

As per our 27 April 2023 submission, the original exposure draft legislation and accompanying explanatory materials were reasonable and ensured the effective implementation of this important disclosure requirement. The measures as originally drafted were line with current international practices being widely adopted globally, for example, public reporting in line with the Global Reporting Initiative (GRI) standards, specifically GRI 207: Tax. Further, the mandating of public CbCR is a logical step in transparency requirements, as MNEs are currently required to produce similar information in countries that are members of the OECD's Inclusive Framework. Action 13 of the OECD's BEPS Agenda (OECD CbCR), which introduced mandatory CbCR reporting to revenue authorities, is a minimum standard for members of the Inclusive Framework. Australia introduced domestic legislation from 1 January 2016.

We make the following specific comments on the current exposure draft.

2. Introduction of an 'Aggregated' Reporting Category

A significant deviation from the original proposal is the introduction of the requirement that selected tax information will only be required on a country-by-country basis for specified jurisdictions, with MNEs having a choice as to whether to publish information for the rest of the world either on a country-by-country basis or aggregated basis. The list of countries where a multinational entity is required to produce country-by-country reporting would exclude separate disclosures of economic data for most of Australia's largest global trading partners,

including nine of the top 10: China, Japan, Korea, India, the United States, Taiwan, New Zealand, Vietnam, and Indonesia.[1] We note in paragraph 1.1 of the Exposure Draft Explanatory Materials, that 'the objective of these amendments is to improve information flows to help the public, including investors, to compare entity tax disclosures, to better assess whether an entity's economic presence in a jurisdiction aligns with the amount of tax they pay in that jurisdiction'. Further, paragraph 1.8 states, 'this builds on global trends to help inform the public debate on the tax affairs of large multinationals'. Legislating two separate categories of reporting defeats these objectives and potentially facilitates obfuscation of profit shifting. The specified list of countries suggests that public debate is centred on the use of tax havens. However, without a full picture of the true tax position in each country where the multinational entity operates, stakeholders cannot assess the difference between what is likely genuine economic activity and activity undertaken as part of aggressive tax strategies.

We acknowledge that the list of specified countries is aligned with the Commissioner of Taxation's International Dealings Schedule specified countries or jurisdictions list. However, it excludes jurisdictions in the European Union (EU) which are Cyprus, Ireland, Luxembourg, and the Netherlands. This is done on the basis that MNEs may be subject to tax information disclosures on a country-by-country basis for EU countries under the EU's public CBC reporting regime (EU Directive 2021/2101). While there is no single globally accepted list of what constitutes a 'tax haven', each of these excluded countries appears on any list that attempts to do so, and they are well-known as countries used for aggressive tax planning. Cyprus, Luxembourg, Malta, and the Netherlands appear on tax haven lists extensively used in the accounting and taxation literature over the past three decades,[2] as well as lists of 'conduit countries' and 'offshore financial centres'.[3] Studies provide empirical evidence that suggests MNEs shift profits to these jurisdictions (see Appendix A).

This current approach of aggregating data also potentially increases compliance costs. While we note that it is optional for entities to aggregate data, a simple alternative would be to require multinational entities to publish the current country-by-country report for transfer pricing purposes, plus the required qualitative data under public disclosure requirements in accounting

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[1] https://www.globalaustralia.gov.au/why-australia/global-connections#:~:text=China%20is%20our%20largest%20trading,significant%20bloc%20for%20Australian%20trade

[2] See, for example, Dyreng, S.D. and B.P. Lindsey. (2009), 'Using financial accounting data to examine the effect of foreign operations located in tax havens and other countries on US multinational firms' tax rates', *Journal of Accounting Research* 47: 1283-1316; Dyreng, S.D., B.P. Lindsey, K.S. Markel, and D.A. Shackelford. (2015), 'The effect of tax and nontax country characteristics on the global equity supply chain of US multinationals', *Journal of Accounting and Economics* 59: 182-202; Hines, J.R. Jr and E.M. Rice. (1994), 'Fiscal paradise: Foreign tax havens and American business', *The Quarterly Journal of Economics* 109(1): 149-192; Brown, R.J., B.N. Jorgensen, and P.F. Pope. (2019), 'The interplay between mandatory country-by-country reporting, geographic segment reporting, and tax havens: Evidence from the European Union', *Journal of Accounting and Public Policy* 38: 106-129.

[3] See, for example, IMF. (2000), 'Offshore Financial Centres IMF Background paper'. Available at: https://www.imf.org/external/np/mae/oshore/2000/eng/back.htm; Garcia-Bernardo, J., J. Fichter, F. Takes and E. Heemskerk. (2017), 'Uncovering offshore financial centers: Conduits and sinks in the global corporate ownership network', *Scientific Reports* 7.

standards. Further, while information may be reported under EU requirements, this may not be consistent in terms of being comparable, nor does it assist stakeholders in accessing the information in a single repository.

The exposure draft explanatory materials currently state that “where a CBC reporting group has prepared a report under the EU Directive 2021/2101, they are expected to publish a link to, or copy of, this report when publishing the tax information required by these amendments”. This requirement is not currently a requirement in the draft legislation. It is our view that the legislation should be updated to ensure consistency between the explanatory materials and legislation.

3. GRI 207 Disclosures versus OECD CBC Reporting Guidance

We note that the disclosure requirements have been adopted from the GRI 207, which also covers a number of disclosure items that form part of the OECD recommendations for CBC reporting. Further, that regard should be had to both the OECD CBC reporting guidance and GRI 207 in interpreting the requirements entities must publish under these amendments. However, there are inconsistencies between the two documents, which will reduce comparability between multinational entities. Given that GRI 207 is specifically designed as a public reporting mechanism, it best suits this role. As such, the Global Reporting Initiative’s Sustainability Reporting Standards should be seen as the preferred approach.

4. Removal of Items from Information that must be Published

The legislation as originally proposed contained requirements for three additional disclosures beyond GRI 207: effective tax rates, expenses from related party transactions, and details of intangible assets. These additional disclosures were proposed on the basis that they would further enhance the CBC disclosures, as the presence of related party transactions and increases in intangible assets are specific indicators of corporate governance risk and would complement the GRI 207 disclosures. The removal of these three disclosure items reduces the effectiveness of public CbCR.

The inclusion of expenses arising from transaction with related parties that are not tax residents of the jurisdiction provides significant information since it informs stakeholders about the amount of income being transferred *out* of Australia and into other jurisdiction, for example by way of interest, royalty payments, and service fees. The inclusion of *intangible* assets also provides significant information because the strategic determination of transfer prices (mispricing) for the use of intangible assets is a primary mechanism by which MNEs shift taxable profits out of Australia. The emergence of knowledge economies as a result of structural changes associated with rapid advancements in information and communication technologies, the rise of the services sector, and the development of new business models, has placed more importance on intangible assets as a source of growth. Rising expenditure on intangible assets is making up an increasing share of many firms’ total assets. Further, the highly mobile nature of intangible assets makes them ideal from a tax planning perspective.

5. Reporting of Employees

We acknowledge the updated requirement to the number of employees ***on a full-time basis*** as per our recommendation in the original submission. However, as per our original submission, reliance on the number of employees as at a single date during the year opens up opportunities for manipulation e.g., individuals employed on contracts that cease on 29 June and recommence on 1 July. Accordingly, we believe the "number of employees as at the end of the income year" should be replaced with "the average number of employees (on a full-time equivalent basis) during the income year". Further, to accurately assess the labour footprint of a firm in a particular jurisdiction, information on employee remuneration is also required. For example, a jurisdiction may have a disproportionately large share of the firm's total employees by number, but these employees may be low-skilled employees. In contrast, a jurisdiction may contain a relatively smaller number of the firm's employees, but these are highly skilled and highly remunerated employees. The disclosure of this information should not be contentious as it is generally presented, in summary form, in the notes to the financial statements.

6. Disclosure of Destination of Sales

Paragraph 3DA(3)(d) and (e) require the disclosure of revenue from unrelated parties and from related parties that are not tax residents of the jurisdiction. The requirement of paragraph 3DA(6) that the information published, "must be based on amounts as shown in the audited consolidated financial statements for the entity for the period that corresponds to the income year" introduces a limitation. Since the consolidated financial statements are an aggregation of the financial statements of the separate entities within the consolidated group ('separate accounting' or 'separate entity' approach), they are prepared on a source basis, not a destination basis. That is, the revenues (or sales) disclosed for a particular jurisdiction represent the revenues (or sales) recognised in that jurisdiction by the relevant group entity (location of the seller). For example, this means that revenues (or sales) recognised in Australia reflect revenues (or sales) booked in Australia, not necessarily revenues (or sales) received from customers *located* in Australia. Ideally, firms would disclose not only their jurisdiction-level source-based revenues (or sales) reflected in their financial statements, but also their destination-based revenues (or sales) i.e., revenues (or sales) made in the end market jurisdictions where goods or services are used or consumed (location of customer).

7. Appendix A: Evidence of Profit shifting to Tax havens

Using public country-by-country-reporting (CbCR) data for EU banks, Brown et al. (2019) find that EU banks report significantly higher profit margins, turnover per employee, and profit per employee for operations located in tax havens relative to non-tax havens and conclude that CbCR provides additional information to better identify the existence and scale of tax haven involvement. More recently, two papers utilise data obtained from the German Federal Tax Agency from individual CbCR reports filed by 333 large German MNEs in accordance with the OECD Action 13 requirements. Fuest et al. (2022a) shows that 82% of the German MNEs subject to CbCR reporting have tax haven subsidiaries. These subsidiaries are notably more profitable than those in non-tax havens. Further, while 9% of German MNEs' global profits are located in tax havens, only 4% of their tangible assets and 3% of their employees are located in tax havens. Similarly, investigating CbCR reports of 434 German MNEs as well as 3,179 foreign MNEs with at least one subsidiary or permanent establishment in Germany, Fuest et al. (2022b) find these MNEs report 7% of their global profits in tax havens but only 0.4% of their employees and 3% of their tangible assets in those locations. They conclude these companies reduce their tax burden by EUR 53 billion (15% of their overall tax payments) by shifting profits to low-tax countries. Finally, Almutairi et al. (2023) investigate the effect of tax haven utilisation on related-party sales pricing for the largest 300 publicly listed Australian firms for the period 2008-2019. They find a positive and significant association between tax haven use and the pricing of related-party sales. That is when a listed company has a subsidiary located in a tax haven, there is a higher probability that its management will engage in profit shifting by manipulating the transfer prices of transactions involving related parties. The authors conclude that the findings suggest policymakers and regulatory bodies could pay closer attention to the use of tax havens by Australian firms.

In summary, the empirical findings of these studies suggest a significant misalignment between the jurisdiction where taxable profits are booked and the real economic presence in those jurisdictions. This underscores the importance of ensuring Australian MNEs are required to disclose data for every jurisdiction they operate in their mandatory public CbCRs.

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