

Tax insights

Your tax affairs in the public spotlight



Snapshot

- A Senate Committee inquiry has been established to consider tax avoidance and aggressive minimisation by corporations in Australia and multinational corporations operating in Australia. It is due to report in June 2015.
- The Senate Committee Chairman recently advised that the Committee had written to 40 ASX listed companies to ask why their effective tax rate is less than 30 per cent.
- Details of possible public hearings have not yet been released, although it is expected that representatives from corporates, the tax profession and the ATO will be invited or required to appear.
- Overseas experience of similar inquiries indicates that the Senate Committee may ask far reaching and detailed questions concerning the structure and tax affairs of corporate groups, particularly multinationals.
- A number of other developments are resulting in greater focus on the tax affairs of companies and the amount of tax paid.

A significant shift in the tax transparency landscape is underway, with a number of developments all resulting in greater focus on tax paid by companies.

Introduction

This *Tax Insights* focuses on the recently announced Senate inquiry into corporate tax avoidance, but that inquiry should be seen in the context of a wider range of tax transparency measures and a number of other recent developments in this area including:

- The proposed Country-by-Country reporting requirements in respect of OECD Base Erosion and Profit Shifting (BEPS) Action 13. Note also that Action 12 is examining the disclosure of aggressive tax planning arrangements
- The publication in 2015 by the ATO of information (including name, total income, taxable income and tax payable) relating to the tax affairs of corporate tax entities with total income of \$100 million or more. The Federal Government has stated that one of the objectives of these amendments is to 'discourage large corporates from engaging in aggressive tax avoidance practices, including base erosion and profit shifting activities', and
- Significantly increased media attention on the tax affairs of specific companies and BEPS generally
- The release of the report entitled *Who pays for our Common Wealth? Tax Practices of the ASX 200*. The assertions in this report have been given significant press coverage.

In response to recent media and 'political' commentary about the amount of tax certain taxpayer groups pay and the capability of the ATO, Second Commissioner Andrew Mills

recently acknowledged that "most taxpayers – and that includes our largest companies, are trying to do the right thing and willingly comply".

Mr Mills expressed concern that some recent "uninformed commentary" about the tax performance of taxpayers and the performance of the ATO did nothing to increase transparency or effectiveness of the tax system, and actually worked to undermine confidence in the system. Whilst he confirmed that debate about tax was welcome, he noted "the debate should deal with facts, not supposition and innuendo".

Senate inquiry

On 2 October 2014, the Senate established an inquiry into corporate tax avoidance and referred this matter to the Economics References Committee (the Senate Committee) to report by the first sitting day of June 2015.

Terms of reference

The Senate Committee inquiry will consider tax avoidance and aggressive minimisation by corporations registered in Australia and multinational corporations operating in Australia, with specific reference to:

- a) the adequacy of Australia's current laws
- b) any need for greater transparency
- c) the broader economic impacts of this behaviour, beyond the direct effect on government revenue
- d) the opportunities to collaborate internationally and/or act unilaterally to address the problem
- e) the performance and capability of the ATO to investigate and launch litigation, in the wake of budget cuts
- f) the role and performance of the Australian Securities and Investments Commission in working with corporations and supporting the ATO to protect public revenue
- g) any relevant recommendations or issues arising from the Government's White Paper process on the "Reform of Australia's Tax System"

h) any other related matters.

The Senate Committee is accepting public submissions to the inquiry until 2 February 2015.

The specifics regarding if and when the Senate Committee will hold public hearings, and who will be invited to appear to give evidence, have yet to be released. However, it is expected that representatives from corporates, the tax profession and the ATO will be invited or required to appear.

Letters to ASX listed companies

On 15 October 2014, the Senate Committee Chairman indicated that he had written to approximately 40 ASX listed companies to request an explanation as to why their effective tax rate (based on their accounting profit) is less than 30 per cent.

Overseas inquiries on corporate tax avoidance

Similar inquiries into corporate tax avoidance have recently been held in the United Kingdom and the United States. Each of the inquiries mentioned above made several recommendations directed to taxpayers, their advisers, revenue authorities and legislators.

United Kingdom

In the UK, an inquiry was held by the House of Commons Committee of Public Accounts (the UK Committee) in November 2012 into the corporation tax paid by multinational companies (UK November 2012 inquiry). The UK Committee was chaired by Rt Hon Margaret Hodge. There was concern that multinational companies were using transfer pricing, payments of royalties for intellectual property or franchise payments to other companies within the group to artificially reduce their profits in the UK and to move those profits to lower tax jurisdictions. The UK Committee held a hearing, inviting representatives from Amazon, Google and Starbucks to provide evidence. Starbucks' global CFO, Amazon's Director of Public Policy and Google's Vice-President for Sales and Operations (Northern and Central Europe) appeared at the hearing. There was some frustration expressed by the UK Committee that the answers to certain tax-related questions were unable to be answered at the hearing by those who appeared.

The UK Committee also held a follow up hearing in May 2013 (UK May 2013 inquiry) at which representatives from Google, EY (auditors of Google) and HMRC appeared.

Two further inquiries were held by the UK Committee into corporate tax avoidance: one in January 2013 which considered the role of large accountancy firms in tax avoidance, at which the Big 4 firms appeared, and another that considered the mass marketing of tax avoidance schemes.

In addition, a House of Lords Committee issued a report in 2013 following its inquiry into *Tackling corporate tax avoidance in a global economy: is a new approach needed?* A wide range of witnesses from the profession, academe, corporates and regulators appeared.

United States

In the US, the US Senate Permanent Subcommittee on Investigations (the US Subcommittee) held a hearing in September 2012 to examine the shifting of profits offshore by US multinational corporations and how such activities are affected by the Internal Revenue Code and related regulations. Witnesses at that hearing included representatives from the US Internal Revenue Service, the Financial Accounting Standards Board, Microsoft (represented by the Corporate Vice President for Worldwide Tax), Hewlett-Packard (represented by the Senior Vice President/Tax Director, accompanied by the Senior Vice President/Treasurer).

The US Subcommittee held a further hearing in May 2013 which examined the structures and arrangements of Apple Inc. This hearing heard evidence from a number of witnesses including the CEO, CFO and Head of Tax for Apple Inc.

More recently, the US Subcommittee has conducted an inquiry to examine Caterpillar's offshore tax strategy. Representatives from Caterpillar at the hearing held in April 2014 included the Vice President-Financial Services Division, the Director of Global Tax and Trade, and a former international tax manager. In addition, the company's tax and transfer pricing advisers appeared before the hearing.

Questions / themes raised at hearings held in the UK and the US

We have reviewed the transcripts of hearings held in the UK and the US and set out a summary of the questions below. Where relevant, we have used Australian tax terminology in place of UK and US tax terminology.

1. Explain the structure of the corporate group within and outside Australia. When was the Australian company (AusCo)/Multinational Corporate Group (MNC Group) first set up in Australia?
2. In what other countries do AusCo/ MNC Group operate?
3. Why was a particular corporate structure put in place?
4. Why was a particular funding structure put in place?
5. Why was a particular supply chain structure put in place?
6. Explain the operations and activities that are undertaken by AusCo/ MNC Group in each country.
7. Why are those activities conducted through those entities in those jurisdictions?
8. Within the AusCo/ MNC Group, where is the underlying economic activity which generates value?
9. Who advised AusCo/ MNC Group to set up this corporate structure?
10. Why did AusCo/ MNC Group establish operations in [Country X]?
11. Have any operations within the AusCo/ MNC Group been established in a jurisdiction because it is a low-tax jurisdiction?
12. Are there companies within the AusCo/ MNC Group that operate through tax havens?
13. Is another member of the corporate group (Subsidiary X) tax resident in the country in which it is incorporated? If not, where is it tax resident? (This was in respect of an Irish incorporated company.)
14. Why does Subsidiary X exist? How is its income generated? How is its income taxed?
15. In the last [X] years, how much has [the Holding Company of AusCo/ MNC Group] received in dividends from its operating subsidiaries?
16. Do you consider that AusCo/ MNC Group has an unfair advantage over domestic-based companies in Australia that do not have the same ability as AusCo/ MNC Group to locate in other countries?
17. What was AusCo's/ MNC Group's turnover in Australia over [years to be specified]?
18. What was AusCo's/ MNC Group's profit both before and after tax [in year to be specified]?
19. How much of AusCo's/ MNC Group's total profits are generated in Australia?
20. How much of AusCo's/ MNC Group's total tax is paid in Australia?
21. In addition to income tax, what other taxes do AusCo/ MNC Group pay in Australia?
22. Has AusCo/ MNC Group negotiated any tax rate reductions with the tax authorities in other jurisdictions?
23. Provide detail regarding the taxes paid to foreign countries including the type and relative amount.
24. What is the size of AusCo's/ MNC Group's internal tax division?
25. How much does AusCo/ MNC Group spend on tax compliance?
26. What is AusCo's/MNC Group's spend on obtaining tax advice?
27. How many employees does AusCo/ MNC Group have in Australia?
28. How many employees does AusCo/ MNC Group have in [each overseas country in which the group operates]?
29. What activities do AusCo's/MNC Group's employees undertake in Australia?

30. What activities do AusCo's/MNC Group's employees undertake in [each overseas country in which the group operates]?
31. Which entity(ies) pay the salary and wages, bonuses and/or provide(s) other benefits to the employees?
32. Where in the AusCo/MNC global group structure is intellectual property owned?
33. Why is intellectual property owned by that entity and in that jurisdiction?
34. In which countries is expenditure made in the categories of research and development, product development, design and engineering services?
35. What is AusCo's/ MNC Group's expenditure on R&D and to what does it relate and to whom is it paid?
36. What is the AusCo's/ MNC Group's global tax rate?
37. What has been AusCo's/ MNC Group's effective tax rate in Australia over the last [x] years?
38. What has been the effective tax rate that the AusCo/ MNC Group has paid in each of the countries in which the group operates?
39. Explain why AusCo/ MNC Group paid Australian tax of [\$X] on income of [\$Y] in the [x] income year(s).
 - a. What was the company's reported accounting profit and/or margins for those years? How do you reconcile the difference?
40. Explain why AusCo's/ MNC Group's effective tax rate in Australia was lower than 30% in the [x] income year.
41. If losses have been made consistently in the business in Australia [or Country X], why are you doing business in Australia [or Country X]?
 - a. What return on capital can investors expect given that the business has been running at a loss over so many years?
42. Is AusCo/ MNC Group currently being audited by the ATO?
43. Describe AusCo's/ MNC Group's relationship with the ATO.
44. Has AusCo/MNC Group entered into any agreements with the ATO (e.g. Advanced Pricing Agreement)?
45. Does AusCo/ MNC Group have any other arrangements in place with the revenue authorities of other jurisdictions in which the AusCo/ MNC Group operates?
46. Describe the GST arrangements of AusCo/ MNC Group.
47. In what circumstances, if ever, has AusCo/ MNC Group breached any Australian regulatory requirement?
48. In what circumstances, if any, has an overseas company within the AusCo/ MNC Group breached their local jurisdiction's regulatory requirements?
49. Is AusCo/ MNC Group being investigated by a regulator (including revenue authorities) in any jurisdiction?
50. Describe AusCo's/MNC Group's transfer pricing policy.
51. Explain the basis for payments made for the use of intellectual property.
 - a. How do those royalty payments flow through the corporate structure?
 - b. In those jurisdictions which receive royalties, what is the percentage of gross and net profit on sales/services delivered in each of those jurisdictions?
 - c. What is the tax rate in those jurisdictions?
52. Describe who are the shareholders [and/or those of the ultimate holding company] of AusCo/ MNC Group?
53. Do you believe that the Australian tax legislation is complex?
54. If a higher rate of tax was payable in Australia [or Country X], would AusCo's/

MNC Group's business leave and to where would it relocate?

55. Does the AusCo/ MNC Group corporate website comment on the ethics of the group and the group's approach to taxation arrangements?
56. What is the AusCo/ MNC Group's view on issues such as consumer power and the value of the corporate group's brand and how that can be influenced by the ethical behaviour or perceptions of the AusCo/ MNC Group?
57. Regarding transparency, how clear should the AusCo/ MNC Group be in explaining to its customers what the group does globally, where it operates and what taxes are paid in the different jurisdictions in which it operates?
58. Do you accept the proposition that profits should be taxed in the countries in which they are made and where genuine economic activity occurs?
59. Do you accept that as well as duties to shareholders, AusCo/ MNC Group has obligations to the societies in which it operates and that those obligations include paying tax?

Next steps

Companies need to prepare and take action in response to the increased scrutiny of their tax affairs from a variety of stakeholders:

- Where companies have been requested to respond in writing to the Senate Committee inquiry on their effective tax rate, draft the response with appropriate input from across the organisation
- Consider whether a submission should be made to the Senate Committee inquiry on any or all of its terms of reference. Submissions are due on 2 February 2015
- Monitor the developments of the Senate Committee inquiry, particularly if public hearings are announced
- Prepare for potentially appearing before the Senate Committee inquiry. Consider the questions which were asked, and the evidence presented, at the public hearings of the recent corporate tax avoidance inquiries in the US and UK. Those hearings may provide an indication of potential scope of the Senate Committee inquiry
- Consider the external / internal (including to Board) response to unsolicited media coverage of tax affairs
- In advance of, or in response to, further scrutiny of tax affairs of corporates, consider a proactive and positive message around the total tax contribution in Australia / globally or even the total economic contribution in the local market
- In the context of the Commissioner's publication in 2015 of information about company tax affairs under the new transparency provisions, consider how to respond, prior to or subsequent to the publication, and what action is required to be taken to prepare for that response.

Contacts

For more information, please contact

Vik Khanna

Partner

+61 (3) 9671 6666

vkhanna@deloitte.com.au

Peter Madden

Partner

+61 (2) 9322 7449

pmadden@deloitte.com.au

Fiona Craig

Partner

+61 (2) 9322 7770

ficraig@deloitte.com.au

David Watkins

Partner

+61 (2) 9322 7251

dwatkins@deloitte.com.au

For further information, visit our website at www.deloitte.com

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