

Tax insights

Your tax affairs in the spotlight: The Senate Inquiry Interim Report



Snapshot

- An interim Senate Report (the Interim Report) entitled “You cannot tax what you cannot see” on the Inquiry into corporate tax avoidance was released on 18 August 2015, making 17 recommendations focusing on tax transparency and financial reporting issues.
- The two Government Senators dissented from some recommendations of the Interim Report citing a failure to recognise recent actions taken by the Government. In contrast the Australian Greens fully support the Interim Report and made additional transparency and financial reporting recommendations.
- Although the Interim Report makes reference to debt loading issues, no specific recommendations were made.
- The final Report is expected by 30 November 2015 with further public hearings expected before then. The Interim Report states that the final Report will focus primarily on transfer pricing and profit shifting with a secondary focus on debt loading, permanent establishments, tax havens, special purpose accounts and the role of accounting firms.
- The Interim Report should be read within the context of the significant shifts in the tax transparency, Australian and international tax landscapes in recent months.

- The heightened media focus that has surrounded the Inquiry and its public hearings has, to date, already served to shine a light on some cross-border tax practices being targeted by the OECD BEPS action plan, and the ongoing activities of the ATO.
- Australia is already firmly committed to increased tax transparency rules, being an early adopter of country-by-country reporting and is also taking unilateral action against the avoidance of permanent establishments (PEs) in Australia with the multinational anti-avoidance law (MAAL) announced in the 2015 Federal Budget.

Inquiry background and ongoing activities

Intense external and media scrutiny of the tax affairs of the ASX 200 in late 2014 was a catalyst for the Senate, on 2 October 2014, to establish an inquiry into corporate tax avoidance and aggressive tax minimisation (the Inquiry). The matter was referred to the Senate Economics References Committee (the Committee). The duration and scope of the Inquiry has expanded over time, and the enquiries of the Committee remain ongoing, with the final reporting date currently as 30 November 2015.

Our previous Tax Insight article on the announcement of the Inquiry can be found [here](#).

Submissions were lodged in early 2015 and there has been a total of five days of public hearings in April and July 2015. As well as tax academics, corporate tax advisers and regulatory authorities a number of high profile multinational companies were also initially invited to appear. Having initially declined to comment on particular taxpayers, the ATO later reappeared to “correct the record” following some of the initial evidence.

The Committee first heard from inbound technology companies, where the focus of the questioning was on the offshore booking of sales income by non-Australian entities, as well as transfer pricing practices. Australian resource

companies were also quizzed with particular attention being given to offshore marketing hubs being used in connection with sales of product which had been extracted in Australia. When the attention of the Committee turned to the pharmaceutical sector, the principal line of questioning related to transfer pricing and the relative price paid for pharmaceuticals imported into Australia versus other markets.

A recurring theme throughout the evidence, also reflected in the Interim Report, has been the role of Singapore – both in the context of inbound technology companies and outbound Australian miners. The Committee has now turned its attention to oil and gas companies and has extended its line of enquiry in respect of Singapore. Submissions have been sought from oil and gas companies, including addressing relationships between their Australian operations and associated operations in foreign jurisdictions, particularly Singapore.

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A strong starting point

The Interim Report acknowledges many positive aspects of the corporate tax system:

- The strength of the existing Australian corporate tax laws
- The efforts of the ATO to bring clarity and consistency to the debate on effective tax rates and fully supports the continued work of the ATO in this area,
- The efforts of the OECD in developing a coordinated response to BEPS,
- The efforts to remove disadvantages for Australian companies when competing with foreign-based entities that arise because of differences in taxation between jurisdictions,
- The initiatives of the OECD to facilitate the exchange of information between jurisdictions and the early adoption of Country-by-Country reporting, and
- The ATO's efforts to work with tax administrators in other jurisdictions to improve collaboration and information sharing between jurisdictions.

A rapidly changing tax landscape

The tax landscape, in Australia and globally, is shifting rapidly with various announcements and developments, many of which have occurred since the Inquiry was initially announced in October 2014. For example, Australia has progressed a number of tax transparency measures including:

- Enacted tax transparency measures requiring the Commissioner of Taxation to report limited details about the tax affairs of corporate tax entities that have total income of \$100 million or more in an income year. The first report is expected to be published in December 2015.
- A commitment to the OECD standards under BEPS Action 13 on Country-by-Country ('CbC') reporting as well as the transfer pricing (master file / local file) documentation from 1 January 2016, with exposure draft legislation having been released.
- The Board of Taxation's current role in working to develop a Voluntary tax disclosure code directed at greater public disclosure of tax information by large

businesses. The Board is due to report back by May 2016.

A number of BEPS-related measures are also under development in Australia:

- The Treasurer has recently stated that the multinational anti-avoidance law (MAAL) provisions will be introduced into Parliament in the near future (expected in the first half of September 2015); this is an integrity measure proposing changes to Part IVA to "negate certain tax avoidance schemes used by multinational entities to artificially avoid the attribution of business profits to a permanent establishment in Australia". The measure will seek to extend Australia's taxing rights by deeming a PE to arise. Penalties for certain transfer pricing and anti-avoidance arrangements have been doubled.
- The Government has proposed to impose GST on imported digital supplies from 1 July 2017.
- The Board of Taxation is also working on the development of anti-hybrid rules under Action 2, Neutralising the effects of Hybrid Mismatch Arrangements. The Board will report back by March 2016.

Meanwhile the BEPS measures are to be largely finalised by October 2015, before the final Report is due.

The Inquiry has also identified current ATO approaches:

- At the Inquiry hearings, the Commissioner of Taxation openly disclosed that the ATO was robustly challenging some of the contentions of particular companies, and that significant assessments had been raised as a result of ongoing audits. The hearings put a spotlight on the ongoing integrity activities of the ATO.
- The ATO has released the so-called effective tax borne (ETB) formula. This arose out of concerns about the way that effective tax rates had been relied upon in evidence. The ATO formula is trying to capture a global group's total worldwide profit from "Australian linked business activities", or the Australian channel

profit. The ATO is continuing to develop the ETB concept via a pilot program. It is expected that the ETB analysis is likely to be used by the ATO as a risk identification tool.

- On 8 July 2015, the ATO also released a guide to help taxpayers assess their risks in respect to related party offshore marketing hubs. We note that more recently the ATO has commenced external consultation on a technical discussion paper on this topic which extends beyond marketing to also include procurement hubs.
- As noted in the dissenting Report, the ATO has been allocated increased resources dedicated to dealing with multinational tax avoidance with private sector expertise and continued funding

Tax minimisation, or tax planning

Legal activity to reduce tax obligations, and is legitimate when it is done within the letter of the law.

Tax avoidance

On the edge of being legal and require investigation (and possibly litigation) to determine whether they are within the law, including the general anti-avoidance rules (GAAR).

Aggressive tax minimisation, or aggressive tax planning

Push the boundaries of what is considered to be acceptable, and may include claiming excessive deductions (such as interest related to debt loading) or complex financing arrangements that may facilitate avoidance of tax obligations.

Tax evasion

Illegal activity to deliberately and intentionally mislead tax authorities in order to reduce tax obligations.

The Interim Report states that the important **initial** question for both Parliament and the broader community is **not which instances of tax minimisation are unlawful but rather which ones are unacceptable**. Having identified any such **unacceptable tax minimisation opportunities**, the next step is for the Parliament to make **legislative amendment** to address such concerns

That is, the Interim Report does not take the view that companies should adopt a “fair share” or moral approach to their tax positions. Noting that companies insist that what they are doing is legal and in the interests of their shareholders, the Interim Report concludes that, if there are concerns about current outcomes (and clearly the Committee has such concerns), Parliament needs to act to amend the laws.

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for the ISAPS program. It also noted the strong relationships that the ATO has with other revenue authorities and improved treaty information exchange developments.

The need for legislative amendment?

The recommendations focus on transparency and financial reporting matters, not tax technical matters. The Interim Report seeks to distinguish between the following types of different behaviours.

Key areas of focus

The main tax practices of multinationals which were commented on in the Interim Report, many of which will be dealt with in the final Report, are:

- Transfer pricing
- The purchase from foreign related parties of goods and services that embody

- significant amounts of intellectual property
- Marketing hubs for multinational mining companies
- Avoiding permanent establishment by providing goods and services from another jurisdiction – including consideration of the MAAL Bill once introduced
- Debt loading and complex financing arrangements
- International restructures

Interim recommendations

The 17 recommendations of the Interim Report cover the following four areas:

- Evidence of tax avoidance and aggressive minimisation
- Multilateral efforts to combat tax avoidance and aggressive minimisation
- Potential areas of unilateral action to protect Australia's revenue base, and
- The capacity of Australian government agencies to collect corporate taxes.

The recommendations are as follows:

1. The Australian Government should work with governments of countries with significant marketing hub activity to improve the transparency of information regarding taxation, monetary flows and inter-related party dealings. This reflects the Committee's concerns that low tax rates in some foreign countries (Singapore and Switzerland are noted) act as an incentive to base erode Australia.
2. The Australian Government should continue to take a leadership role in the OECD BEPS program. If a coordinated response does not materialise in an acceptable timeframe, then Australia should reserve the right to take unilateral action where necessary
3. The implementation of a mandatory tax reporting code as soon as practicable but no later than the current timeframe for the proposed voluntary public transparency code (see below). Any Australian corporation, or a subsidiary of

a multinational group, with an annual turnover above an agreed figure would be required to publicly report financial information on revenue, expenses, tax paid and tax benefits/deductions from specific government incentives, such as fuel rebates and research and development offsets.

4. The existing tax transparency disclosure, expected in December 2015, should apply to both private and public companies (there are current Government proposals to exclude private companies).
5. Based on concerns expressed during the hearings of the ATO dispute settlement process, the establishment of a public register of tax avoidance settlements reached with the ATO where the value of the settlement exceeds an agreed threshold.
6. To further increase transparency around disputes, the Government should consider publishing excerpts from the Country-by-Country reports (committed to by Australia from 1 January 2016), and consider implementing Country-by-Country reporting based closely on the European Union's (EU) standards. On this, it is notable that there is no final and enacted position as yet on EU standards.
7. Based on concerns that Parliament lacks the necessary information to assess the integrity of the system, the Committee has recommended that the ATO, Treasury and other relevant agencies should provide an annual public report on the activities of multinational groups including an estimate of tax forgone due to corporate tax avoidance schemes, an assessment of policy responses to that date and any further potential policy responses.
8. The Australian Government tender processes should require bidder companies to state their country of domicile for tax purposes.
9. Mandatory notification by agencies to the relevant portfolio Minister when contracts

with a dollar value above an agreed threshold are awarded to companies domiciled offshore for tax purposes.

10. In the interests of the government and community, there is an independent audit of whether there is sufficient ATO resourcing, funding and staffing.
11. The ATO reports to Parliament at least annually on:
 - the number of audits or disputes launched concerning multinational corporations
 - the number of cases settled with multinational corporations
 - the number of successful legal proceedings concluded against multinational corporations, and
 - staff resources allocated to tax compliance of multinational corporations.

From a financial reporting rather than a purely tax perspective, the Interim Report also made the following recommendations:

12. To ensure that the ATO has proper access to relevant information, amend taxation legislation so that non-reporting entities are required to disclose related party information in financial reports under the Corporations Act if notified to do so by the ATO
13. The concept of 'grandfathered large proprietary companies' should be removed from the Corporations Act, and these companies be required to lodge financial reports with the Australian Securities and Investments Commission (ASIC)
14. Require all proprietary companies to review and confirm their size with ASIC annually to maintain reporting exemptions
15. Again, to ensure that the ATO has proper access to relevant information, the confidentiality provisions in the ASIC Act should be amended so that ASIC can

share information with the ATO without having to inform the affected person or company

16. Require people who propose to become directors of companies to provide evidence of their identity to ASIC
17. Ensure that a company is not eligible for financial reporting relief where the ATO notifies both the company and ASIC that the relief does not apply to that company

The dissenting Report of the two Government Senators states that the 17 recommendations should be considered within the context of current Government initiatives.

What about debt funding?

The Committee did note concerns that debt loading practices are enabling some multinational organisations to continue to shift profits from Australian operations to lower tax jurisdictions. It noted (consistent with previous announcements by the Opposition) that a "fairer way to determine an appropriate debt deduction is to base the tax deduction on a company's entire global operations". However, the Committee made no recommendations on this matter. Multinationals will need to keep an eye on the final Report and developments in BEPS Action 4.

Additional recommendations by the Australian Greens

The Australian Greens also added the following, largely regulatory, recommendations:

1. The ATO be required to publish the details of the top 10 Australian companies that transfer wealth off shore in each financial year. A right of reply to be afforded to each named company to justify its transactions.
2. Australian companies that are part of a larger group of international companies should not be eligible for special purpose accounting treatment and must provide ASIC with detailed financial reports to prevailing accounting standards.

3. Australian companies that are part of a larger group of international companies should include in their financial statements the value and purposes of all transactions between related companies.
4. ASIC should publish all details of exemptions from general purpose accounting by firm and association to global related parties, with a justification from ASIC as to why the exemption is necessary. ASIC should also publish any exemption from reporting timelines and clearly outline any changes to class orders that are implemented.
5. In the absence of a compelling public policy purpose, the government should abandon legislative changes exempting private companies from providing minimal details about their profitability and taxes.
6. That Parliament establish a public register of beneficial ownership of companies and trusts so that identification of financial beneficiaries can be traced and publicly identified. The Australian government should also work closely with other countries to establish a global standard for such registers.
7. That the Senate pass the Corporations Amendment (Publish What You Pay) Bill 2014.

Report and will need bipartisan support to make legislative changes.

Nonetheless, whether or not some or all of these recommendations are adopted, it is already evident that the tax governance and the international landscapes are continuing to shift significantly which will give rise to challenging issues for tax directors, audit committees and boards of directors.

As well as readiness for the reporting requirements themselves, companies will need to continue to prepare for, and start to take action in response to, the increased scrutiny of their tax affairs from a variety of stakeholders.

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This will include consideration of the external and internal responses to media coverage of tax affairs to align the understanding of all stakeholders on a group's risk and overall tax profile.

In December 2015, when the Commissioner's first tax transparency report is published, large corporates can expect the media to examine its contents in detail. They can also expect their tax affairs to come under scrutiny from a range of other stakeholders.

Further ahead in 2016, companies need to determine a clear view of the impacts of the forthcoming BEPS-related actions.

Additionally as requested by the Australian Greens, the final Report will consider special purpose accounting and the need for greater forensic examination of a company's activities

The road ahead?

Further public hearings are expected and the final Report is currently to be issued on or before 30 November 2015.

These interim recommendations made therefore will remain subject to the publication of the final

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