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Tax Insights

ATO estimates large corporate tax gap

Snapshot

On 11 October 2017 the ATO released a new publication called "Tax and Corporate Australia" addressing the tax performance of the top 1,400 large corporate groups (turnover >$250m) for the 2014-15 year.

The publication contains the ATO's tax gap estimate for the segment, being approx. $2.5 billion, or 5.8% for the year ended 30 June 2015. This is relative to company tax paid by this segment of $41 billion (total company tax collections for 2014-15 being approx. $68 billion). This is the first time the tax gap for large corporates has been released by the ATO.

The ATO considers that there is a "strong compliance culture" in the large market. The tax regulator acknowledges that the tax affairs and transactions affecting large business are complex, and there can be reasonable differences of opinion. It will take firm action on those who deliberately avoid their tax obligations or choose not to comply

The good news

The ATO considers the relatively low tax gap estimate reflects a tax system that is operating well. The 5.8% tax gap estimate in 2015 demonstrates a high degree of voluntary compliance, and compares well globally. Whilst the ATO has not released tax gap data for this segment before, it has analysed the gap going back to 2009 and concluded that the tax gap trend for large corporate groups has been relatively steady over that period.

The gap estimate is in line with the United Kingdom, which has an estimated tax gap of approximately 5 to 6% for its large business segment.

The ATO acknowledges that whilst some large corporate groups may engage in tax minimisation or avoidance, typically, large corporate groups are not reckless and do not evade tax.

Concentration and contribution of the large corporate group sector

The publication notes that whilst the population of large corporate groups in Australia is small (approximately 1,400 groups), this taxpayer segment makes a significant tax contribution ($41 billion in corporate income tax in the 2014-15 financial year). The tax contribution of these large corporate groups makes up approximately 61% of all corporate income tax reported.

In particular, the largest 10 corporate groups contributed $20.5 billion or 30% of all corporate income tax reported. The largest 100 corporate groups pay about half of all corporate income tax.

Importantly, it is because of this concentration that it is possible for the ATO to obtain assurance over a large proportion of the corporate income tax base. On the other hand, the relatively heavy reliance on corporate tax as a government revenue source, coupled with this concentration raises risks to the sustainability of the government’s tax revenues.

Compliance factors

The ATO notes that large corporate groups have effectively full compliance with three of the four OECD pillars of compliance;

- Registration in the system
- Lodgement of returns (79.4% on time) or within a reasonable period and
- Payment (96% on time).

However, the key focus area with large corporate groups is on the fourth pillar of compliance; the correct reporting of their taxable income (which is where tax gap estimates provide a measure).

What does the gap represent?

The tax gap is the estimated difference between the tax payable according to the law, and the amount of tax actually paid. The vast majority of tax paid is done so on a business as usual voluntary basis, whilst ATO audit activity collects further tax.

The ATO has indicated that in the large corporate group market, the tax gap primarily represents differences between the ATO and taxpayers' interpretation of complex areas of the tax law.

Disputes are generally in 'grey' areas such as transfer pricing and the borderline between acceptable tax planning and tax avoidance. In most cases compliance activity has involved 'reasonably arguable' interpretations of tax laws and the low penalties imposed on corporates reflect this position.

Some of the most common issues that have given rise to an adjustment in recent years are transfer pricing and thin capitalisation, treatment of offshore income and the use of controlled foreign companies, business restructures and debt–equity tax arbitrage.

Reducing the tax gap in the future

The ATO goal is to sustainably reduce the tax gap to a minimum achievable level, noting that a zero tax gap is not practically achievable.

Importantly, the ATO is confident that new strategies and laws are already having a significant impact on sustainably reducing the large corporate group income tax gap. These strategies and laws include:

- Applying tougher domestic laws such as the multinational anti-avoidance law (MAAL), Diverted Profits Tax (DPT), other enhancements to the General Anti-Avoidance rules (Part IVA) and transfer pricing rules
- Generally only settling prior year disputes where there is also agreement to lock in the appropriate treatment for future years
- Utilising additional information available under Country-by-Country (CbC) reporting, Reportable Tax Position schedules and automatic exchange of rulings for specific taxpayers
- Reviewing corporate governance frameworks and practices
- Issuing more guidance around ATO views of spectrums of tax behaviour such as Practical Compliance Guidelines (PCGs) and Taxpayer Alerts
- Greater assurance activities supported by increased internal capability within the ATO and specialist talent from outside the ATO. This includes performing detailed one-to-one reviews of the large corporate group population. For the top 100 these reviews occur annually, for the remainder they occur on a four year cycle
- Reviewing tax outcomes holistically when providing taxpayers with certainty via a ruling or advance pricing arrangement
- A greater strategic focus on addressing important systemic issues including, where appropriate, through litigation.

Compliance activity results

The ATO advises that income tax returns for large corporate groups are adjusted on average by around $1billion each year, excluding interest and penalties. A small number of high value adjustments account for most of the total value.

Included in the ATO publication is a summary of the results of corrective action targeting large corporate groups in respect of income tax over the past five years.

	2011-2012 $M	2012-2013 $M	2013-2014 $M	2014-2015 $M	2015-2016 $M
Value of liabilities raised via assessments	1,633	2,147	1,602	2,471	1,354
Cash collected (or audit yield)	636	1,852	1,011	1,685	703
Tax losses denied	583	1,539	1,170	1,462	680

Recent reports from the ATO indicate that these figures will be eclipsed in the 2016-17 and later income years.

Relevantly in August 2017, the ATO reported to the Senate Inquiry into Corporate Tax Avoidance that it had raised over $4 billion in assessments of which more than $1 billion has been collected to date.

In addition, the judgement in Chevron Australia Holdings Pty Ltd was considered by the Commissioner to be "one of the most important decisions ever in corporate tax in Australia" and, across the market generally, is estimated to bring in more than $10 billion of additional revenue over the next 10 years in relation to transfer pricing of related party financing alone.

There are now over 1,300 staff dedicated to servicing the tax compliance of the large corporate groups. One-on-one engagement with the large corporate group population, new data sources and information obtained through the ATO's statutory powers have led to increased confidence within the ATO that they are making substantial progress in identifying and addressing the risks that taxable income is not being reported correctly.

We therefore expect that longer term reporting will reflect a narrowing of the large corporate group tax compliance gap.

Further Tax Gaps to issue

In previous years tax gap estimates for GST, Wine Equalisation Tax, Luxury Car Tax and Petrol & Diesel excise have been released via the ATO annual report around November each year. More recently, in addition to the large corporate tax gap, the ATO has released the Superannuation Guarantee gap for the first time.

The ATO is still to issue a tax gap for the small to medium business market, high wealth individuals or individuals more generally. To provide some context to the expectations around these segments, the UK's estimated small and medium sized enterprises income tax gap between 2009-10 and 2014-15 has been approximately 10% on average. It is expected that these additional tax gap estimates will be released progressively due to the difficulty in estimating these gaps reliably, to some extent due to the prevalence of the black economy.

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