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Trends in tax transparency: The story so far…

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1 Introduction

[1]There is a trend towards greater corporate tax transparency in Australia and internationally.

“Tax transparency” involves companies divulging their sensitive tax information – typically in one of the following two ways:

- first, by the company to the public – mandatorily, voluntarily or “voluntarily” (due to public pressure)
- second, by the company to Government – for the Government’s own use (to administer the local tax system) or to exchange with other Governments (to administer their tax systems).

A third way is perhaps less common but becoming prevalent: a disenchanted employee (or some other type of “whistle blower”) “leaks” sensitive information to the public.

Australia is following a trajectory of increasing public tax transparency. This has commenced recently with a limited mandatory corporate tax disclosure regime (s.3C disclosure, refer section 2) and will soon progress to a “voluntary” corporate tax disclosure (Tax Transparency Code, refer section 3).

This increased public disclosure is accompanied by increased company to Government disclosure. Most notably, here and internationally, with Country-by-country reporting (refer section 4). Whilst not strictly tax disclosure, the Common Reporting Standard represents another example of the “to Government” disclosure (refer section 5).

There are other international tax transparency initiatives arising from the OECD’s Base Erosion and Profit Shifting Project. These include the exchange of private rulings and the early disclosure of aggressive tax positions (refer section 6).

And so the story begins …

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All legislative references are to the *Income Tax Assessment Act 1997* or the *Income Tax Assessment Act 1936* unless otherwise indicated.

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2 Mandatory tax disclosure

2.1 Introduction

Australia can proudly say it is a world leader when it comes to mandatory public disclosure of tax information.[2]

This section provides an overview of the current law (including how we got there), before discussing the recent two tranches of disclosures, the shortcomings with what we have got, and where this mandatory disclosure is likely to go.

2.2 Overview of current law

Section 3C of the *Taxation Administration Act 1953* (**TAA**) requires the Commissioner of Taxation (**Commissioner**) to annually publish certain prescribed information regarding "corporate tax entities"[3]. The trigger for disclosure is:

- where a corporate tax entity reports $100 million or more of "total income" on its tax return for a given year
- *unless* that corporate tax entity is an Australian resident private company with 50% or more Australian resident shareholders (**Australian 50% private company**) – in which case the threshold jumps to $200 million.

This disclosure (**s.3C disclosure**) is designed to have a very low compliance burden - for taxpayers and the ATO. To that end, "total income" is taken directly from Label 6S on the corporate tax entity's tax return Form C. When the applicable threshold is triggered, then the Commissioner is required to make publicly available the following information (all sourced from the taxpayer's tax return):

- total income (Label 6S): essentially, gross income or turnover for accounting purposes
- taxable income (Label 7T): total assessable income less allowable deductions
- tax payable (Label T5): tax payable <u>after</u> allowing for tax offsets (such as franking credits, foreign income tax offsets and R&D tax offsets)

together with the taxpayer's Australian Business Number.

[2] Refer to comments in Mindy Herzfeld's article: "Australia's First Public Tax Disclosures –Lessons Learned" *Tax Notes International* (11 January 2016):

> *"Pressure for public disclosure of multinationals' country-specific tax information has been building over the past few years. … [the] biggest success to date is in Australia, which in 2013 mandated public disclosure of multinationals' tax information."*

[3] A "corporate tax entity" is defined in s.950-115 to include companies and other entities that are treated as companies for income tax purposes – for example, Division 6C public trading trusts.

The disclosure also covers Petroleum Resource Rent Tax and Mining Resource Rent Tax payments. However, this is beyond the scope of this paper.

2.3 How we got to the current law

How we got to this point represents a colourful chapter in Australia's tax political history.

2.3.1 The original tax transparency measure

Section 3C was introduced by *Tax Laws Amendment (2013 Measures No. 2) Act 2013* by the then Labor Government.[4] The original measure applied a $100 million "total income" trigger – that is, it did not distinguish Australian 50% private companies and other taxpayers.

The Explanatory Memorandum (**EM**) to the enacting Bill made the following observations:

- *5.5 The apparent ease with which some large corporate and multinational entities can shift taxable profits and erode a country's tax base is a shared concern for G20 and most OECD countries.*
- *5.6 The <u>first objective</u> of these amendments is to discourage large corporate tax entities from engaging in aggressive tax avoidance practices.*
- *5.7 The <u>second objective</u> of these amendments is to provide more information to inform public debate about tax policy, particularly in relation to the corporate tax system.*

This measure took effect from taxpayers' 2013-14 income year.

2.3.2 The "Better targeting the tax transparency laws" amendment

Section 3C was amended in 2015 by *Tax and Superannuation Laws Amendment (Better Targeting the Income Tax Transparency Laws) Act 2015*. Specifically, s.3C(1) was amended to completely exempt Australian 50% private companies from s.3C disclosure.

As the Commissioner had not at that time disclosed tax data for the 2014 income year, then the measure could apply from that year – effectively paring back the original Labor measure to public companies and majority foreign owned private companies with "total income" of $100 million or more.

The EM to the enacting Bill expressed various concerns with applying s.3C disclosure to Australian 50% private companies, including:

- 1.11: Australia's income tax transparency laws represent a significant departure from the established framework for the protection of <u>sensitive taxpayer information</u>.

[4] Ironically, it replaced a previously repealed section in the TAA entitled "Secrecy"!

- 1.15: Many private companies have raised legitimate concerns about the commercial sensitivity of the information and the impact of disclosure on their personal privacy and security.
- 1.16: The information may be used in commercial negotiations to the advantage of larger firms and potentially cause loss to t the company.
- 1.17: As certain trusts, not being corporate tax entities, are not covered by the public disclosure, private companies may be encouraged to restructure to minimise commercial disadvantage.
- 1.18: Many private companies would bear a disproportionate cost in publishing additional information in order to protect their reputation and provide necessary context to the public about their tax affairs.

2.3.3 The $200 million political compromise

Section 3C was amended again in December 2015 to reinstate Australian 50% private companies within the s.3C disclosure ambit – albeit with a $200 million threshold trigger. The practical consequence of this amendment was that only 300 rather than some 900 Australian 50% private companies would face disclosure for the 2013-2014 income year.

2.3.4 Political theatre

The justification for the "better targeting" measure was always controversial. The Government was ridiculed for one of its justifications: that their owners would more likely become the target of kidnapping if their tax data was made public.[5] This claim was made by Finance Minister Mathias Cormann,[6] as well as the then Assistant Treasurer, Josh Frydenberg, and is also alluded to in the relevant EM.[7]

These remarks did the Government no favours in making the case for the exemption[8] and, in the author's view, overshadowed some of the many legitimate justifications for the "better targeting" measure – discussed later.

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[5] In particular, Jeffrey Knapp, a lecturer in the School of Accounting at the University of New South Wales made the (rather unqualified) remark that this justification *"is the stupidest excuse for non-disclosure I've ever heard"* (refer Knapp J, "Kidnap risk among excuses for non-disclosure of big business tax put to Senate Inquiry" ABC News: The Conversation (updated 1 October 2015).

[6] Khadem N, "Like it or not, we're moving to a world of greater tax transparency, not less" *The Sydney Morning Herald* (15 October 2015).

[7] For example, refer to [1.12] and [1.37].

[8] For example, it appears that the Government did not seek or receive any advice from the Australian Federal Police or their other security advisers regarding the statements around kidnapping and "security concerns". Instead, support for these statements appear to have come only from oblique references in two submissions on the exposure draft legislation (refer Aston H, "Abbott government sought no security advice on kidnapping fears before protecting wealthy from tax disclosure" *The Sydney Morning Herald* (8 June 2015).

Nonetheless, the "better targeting" measure managed to get through Parliament. Labor and the Greens did not support this measure. However, 6 of the 8 cross-bench Senators did – at least initially in the case of Senators Nick Xenophon and Ricky Muir. The measure was passed on 15 October 2015 – but with some controversy, as various Senators were not in the Chamber when the Bill was scheduled for discussion, allowing the Government to push the legislation through. The Act received Royal Assent on 12 November 2015.

In the period between the passage of the Bill and Royal Assent there appears to have been some political manoeuvring by opponents of the "better targeting" measure. In particular, Senators Xenophon and Muir reversed their support for exempting Australian 50% private companies from s.3C disclosure – apparently at the behest of Senator Sam Dastyari (Labor). One of the excuses bandied around for this was, as Greens Senator Peter Whish-Wilson put it, the Senate had been "astroturfed" by an organisation called the Family Office Institute Australia.[9]

To that end, around the same time, the Senate was considering the *Tax Laws Amendment (Combating Multinational Tax Avoidance) Bill 2015*. This Bill contains the centrepiece of the Government's response to the Base Erosion and Profit Shifting (BEPS) Project: the multinational anti-avoidance legislation (the "MAAL") and country-by-country reporting (refer to section 4).

On 11 November 2015, the Greens inserted an amendment to completely repeal the *Tax and Superannuation Laws (Better Targeting the Income Tax Transparency Laws) Act 2015* - which, as noted above, received Royal Assent the next day!

Not unsurprisingly, the Government rejected the Senate's amendments. Ultimately, the Coalition reached an agreement with The Greens to pass the MAAL and CbC measures. That compromise included:

- lifting the Australian 50% private company threshold for s.3C disclosure from $100 million to $200 million of "total income"
- inserting a new s.3CA of the TAA - requiring "significant global entities" that are Australian tax residents or foreign residents with an Australian permanent establishment to annually provide the Commissioner with general purpose financial statements.

The deal infuriated Labor. Labor Senate leader Penny Wong accused The Greens of being "tax transparency traitors" that were part of a "dirty deal".[10]

No doubt all of this political theatre would make the likes of Frank Underwood proud!

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[9] For more on these allegations and a description of "astroturfing" refer to Aston H, "Senate repeals tax law after 'astroturf' revelations" *The Sydney Morning Herald* (11 November 2015). Also refer to Aston H, "The 'institute' with no members embarrasses Senate Committee" *The Sydney Morning Herald* (8 November 2015) which suggests that in fact only two Senators said that they were "astroturfed" rather than the whole Senate.
[10] Heath A, "Greens deal with Scott Morrison on tax shield sparks Labor fury" *The Sydney Morning Herald* (3 December 2015) and Coorey P and Mather J, "Greens and Coalition clinch tax avoidance deal" *Australian Financial* Review (3 December 2015).

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2.4 Disclosure of 2013-14 income year tax data

2.4.1 Overview

The first tranche of 2013-14 income year tax data was published by the Commissioner on 18 December 2015 - disclosing tax data for some 1,539 corporate tax entities. The disclosure did not include Australian 50% private companies – given the timing around the political compromise discussed above. On 22 March 2016 the file was updated to include tax data for 321 Australian 50% private companies.

The disclosure comprises an excel file – searchable and sortable by each data type provided.

2.4.2 Accompanying ATO explanation

Accompanying the excel file are several documents that provide some context and further information regarding each tax data disclosure.[11] The Australian Taxation Office (**ATO**) should be commended for putting this together – it goes some way to explaining what otherwise is just a disjointed set of numbers in isolation. To that end, the ATO accompanying material observes the following:

- There are approximately 1.1 million companies operating in Australia that reported total income tax payable of $68.4 billion in the 2013-2014 income year. The 1,859 companies included in the s.3C disclosure comprise 63% of that population.
- The ATO attempted to explain the (very loose) relationship between "total income" and "taxable income" – for example, situations where accounting profit differs from taxable income include: accounting versus tax group, the application of prior year tax losses, the foreign income participation exemption, etc.[12]
- That "tax payable" is determined after allowing for franking credits, R&D and other tax offsets.
- The ATO were at pains to highlight that nil tax payable does not *"necessarily"* constitute tax evasion.[13] In particular, the ATO observed:
    - Of the 38% of companies that did not pay tax (i.e. had a nil amount disclosed at "tax payable"), 22% had a current year loss, 8% had a prior year loss and 7% utilised franking credits and other tax offsets to eliminate any tax payable.[14]
    - *"The effects of the GFC are still being seen in corporate profits and tax results in 2013-14"*

[11] The report and the accompanying explanatory documents can be found at https://www.ato.gov.au/Media-centre/Media-releases/Corporate-tax-transparency-data/.
[12] Refer to the heading Factors affecting taxable income in "Tax transparency reporting of entity tax information" (refer above link).
[13] ATO Media Release: "Statement by Commissioner of Taxation, Chris Jordan AO on corporate tax transparency" (22 March 2016).
[14] Khadem N, "Zero tax: Half of Australia's 1300 public companies have been under ATO review" *The Sydney Morning Herald* (18 December 2015).

    - *"… approximately 63% of all ASX listed companies reported a loss to their shareholders in the 2013-14 financial year."*

    - *"Over the past 10 years, 20 to 30 per cent of the comparable grouping of ASX 500 companies has reported a net loss to their shareholder in any given year. The [s.3C disclosure] tax data reflects similar levels of tax losses reported by economic groups."*

- There are some *"specific areas where relationships in the reported data may be more difficult to interpret"*. For example, stapled groups, life insurance companies and taxpayers with an offshore banking unit (**OBU**).

- *"The reported figures do not themselves indicate whether an entity is paying a high or low rate of tax. Measuring a company's "effective tax rate … and comparing effective tax rates across single entities does not take into account related party transactions, the broader economic group or a number of other factors."*

And specifically in relation to Australian 50% private company groups.

- Many private groups consist of a number of entities whose total income aggregates to more than $200 million. Nonetheless, where these entities are not consolidated, then these groups will not be included in s.3C disclosure. That is, other than income tax consolidation itself, there are no grouping provisions for s.3C purposes.

- The ATO risk assesses 100% of the privately owned and wealthy group population to ensure companies comply with their tax obligations.

Finally, accompanying ATO material also observe that:

- The report will not be updated to reflect amended assessments subsequent to the reporting date.

- "*Confidentiality provisions of the tax law prevent the ATO providing information about particular taxpayers beyond the information provided in the report. However, some entities and organisations have chosen to provide further context and explanation on their own websites, or in financial or tax reports."*

2.4.3 Public reaction to the disclosure

The December and March disclosures were not followed by rioting, protesting or even the (re-) occupation of Martin Place. Instead, the coverage by (reputable) media outlets was mostly fair and reasonable.

The media coverage suggests that, at least for the most part, the journalists "got it" – that is, no tax payable does not equal tax avoidance. The coverage reflected a general understanding that prior year losses continue to deplete current year tax payable.

Indeed, it appears that the December disclosure publicly highlighted the difficult trading conditions facing many companies – including for those dreaded foreign multinationals. For instance, the Australian Financial Review reported:

> In total 579 companies paid no tax reflecting difficult trading conditions for miners, manufacturers and agricultural companies. The worst performers were foreign banks, with 45 per cent failing to break even.[15]

Evidently, the ATO material accompanying the s.3C tax disclosures succeeded in informing the way the tax data needed to be interpreted. The ATO should be commended for this.

That is not to say that no action was taken by the disclosing companies to manage the disclosure of their sensitive tax data. The Sydney Morning Herald's Nassim Khadem reported:

> Top executives have been preparing the PR battle. Within hours of the list being released, the corporate spin doctors were on the phone to journalists explaining why they paid zero tax. In some cases, there were legitimate reasons (mining and manufacturing have taken a hit and this loss shows up in the data as zero tax).
>
> In others, only part of the story is being told. The headline rates fail to show money that has been routed through low-tax nations like Singapore, Ireland and the Netherland, or no-tax jurisdictions such as Bermuda.[16]

It was also not the case that all the coverage simply accepted the fact that many companies with large revenues paid no tax. Predictably, journalists published lists of the top "no-tax" taxpayers to highlight the contradistinction with their large revenues.[17]

2.5 Some observations regarding s.3C disclosure

In the author's view, s.3C disclosure represents a deficient "half measure". The disclosure is supposed to further two objectives: #1 discourage corporate tax avoidance; and #2 inform public debate (refer to the original "better targeting" EM). However, it is difficult to see how s.3C can achieve either of those objectives. These deficiencies are amplified in the context of Australian 50% private companies.

Below is a brief outline of some of the shortcomings of s.3C disclosure.

2.5.1 Simply not enough information!

It is trite that corporate taxation is complicated. Providing the public with three numbers – each the end product of multiple calculations – is misleading.[18]

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[15] Chenoweth N, Riordan P and Tadros E, "Good, bad, ugly: ATO reveals all" *Australian Financial Review* (18 December 2015) at 3.

[16] Khadem N, "The corporate lie: tax transparency 'misleading'" *The Sydney Morning Herald* (18 December 2015).

[17] For example, refer to Aston H, Khadem N and Butt C, "Four in 10 companies pay this much tax … $0" *The Sydney Morning Herald* (17 December 2015).

[18] Noel Rowland (Chief Executive, The Tax Institute) observed *"It's really easy to take a headline-effective tax rate and say 'Oh look so-and-so is paying 25c in the dollar. The corporate rate is 30 so they must be dodging tax.' It's much more complex than that."* cited in Mather J, "Kidnap fears 'the stupidest excuse' for winding back tax disclosure laws: accounting academic" *Australian Financial Review* (19 March 2015).

This is exacerbated by the only loose correlation between each of these three numbers – especially between "total income" (which excludes expenses) and "taxable income" (which not only includes expenses, but also reflects adjustments between tax law and accounting concepts).

Critically, the "three number" disclosure does not inform the relationship between a company's profits and the tax that the company paid – and hence the company's effective tax rate.[19] Including a fourth label: "Total profit or loss" (Label 6T) would, at the very least, provide the public with the ability to calculate a "rough and ready" effective tax rate.

Where a company had large tax offsets (such as a holding company that receives amounts of franked dividends) then this "four number" disclosure remains misleading. Perhaps the tax payable disclosure should be *before* applying tax offsets (Label T1 not *after* (or possibly disclose both).

The lack of real information elicited by s.3C disclosure is evidenced in the media reporting of the December 2015 and March 2016 disclosures. Journalists could do little more than produce pretty graphs to display parts of the tax data[20] and then surmise, speculate and suspect. No companies were exposed as tax cheats and the public was not informed.

Apparently, the answer is that companies can *choose* to disclose further information to clarify their three numbers. However:

- for many companies this will not be a choice – they will need to do this to protect their brand
- for some others, they may have in any event voluntarily disclosed such information as part of their corporate social responsibility reporting (discussed in section 3.5 below).

Many Australian 50% private companies do not have a public presence (think private family investment company) and do not maintain a website. If such companies do wish to disclose further information about their tax affairs, they will need to consider practically the best way to actually do this.

In the author's view, a mandatory disclosure regime that is so limited that it requires other "voluntary" disclosures is suboptimal.

2.5.2 Misinformation

Section 3C disclosure does not accommodate changes in a taxpayer's tax data for a given year. That is, s.3C does not require the Commissioner to re-publish revised tax data for companies that have (one or more) amended assessments – and hence the Commissioner cannot do so.

Consequently, the many taxpayers that do from time to time have their assessments amended will forevermore have incorrect tax data on the public record.

There are some sensible administrative/compliance reasons why s.3C disclosure has been designed this way. Nonetheless, those reasons need to be weighed up against this misinformation.

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[19] Herzfeld M, "Australia's First Public Tax Disclosures – Lessons Learned", *Tax Notes International* (11 January 2016) at 107.
[20] For example, refer Aston H, Khadem N and Butt C, note 17.

2.5.3 Dividend imputation system

The purpose of the dividend imputation system is that corporate tax payments should be imputed onto the company's "real" Australian resident natural person shareholders.[21] Accordingly, corporate tax is a withholding mechanism to the extent that the company profits end up in the hands of resident shareholders. For non-resident shareholders, company tax is effectively a final tax.[22]

It makes sense then to care about how much corporate tax foreign multinationals pay. To that end, mandatorily disclosing some of their tax data is defensible.

However, the same cannot be said for Australian 50% private companies. To the extent companies have Australian resident shareholders, corporate tax is merely the first layer of tax "withheld". The tax ultimately paid on such companies' profits will depend on how and when those profits are distributed.

Accordingly, in the author's view, disclosing Australian 50% private company tax data misleads rather than informs public debate.[23] The total tax ultimately paid may be more – or indeed it could be much less!

2.5.4 Ease of avoidance

As previously mentioned, the Coalition Government's "security concerns" justification may well have overshadowed some of the other (more credible) justifications for the "better targeting" measure. In particular, the "better targeting" measure EM (at [1.17]) remarked that s.3C disclosure could encourage companies to restructure to avoid disclosure.

This could be achieved in a number of ways, including:

- **Use a trust rather than a corporate structure to carry on business**: Trusts are not subject to s.3C disclosure.[24]
- **Separate a company's business into multiple (non-tax consolidated) companies:** There is no aggregation/associate inclusion rule that applies to s.3C disclosure.
- **Adopt accounting policies that result in "total income" being less than the applicable disclosure trigger threshold:** For example, AASB 9: *Financial instruments* provides for the

[21] To that end, through the "gross-up and (tax) offset" mechanism in Division 207, where a particular individual shareholder's marginal rate exceeds the corporate tax rate, then that shareholder generally pays "top-up" tax. Conversely, where the shareholder's rate is below the corporate rate, then a refund of franking credits is generally available.

[22] A franked distribution is exempted from dividend withholding tax under s.128B(3)(ga). However, non-residents are generally not entitled to a tax offset for franking credits accompanying franked distributions received.

[23] The author is not the first person to observe this. The EM to the Bill that introduced the "better targeting" measure observed (at [1.15]): *"The nature of the information disclosed can be misleading in that it ignores the residual liability on the owners for personal income tax payable on the company's distributed after tax profits."*

[24] Closely held trusts are typically unlikely to be "public unit trusts" for Division 6C purposes (especially when the amendments in Schedule 5 of *Tax Laws Amendment (New Tax System for Managed Investment Trusts) Act* 2016 take effect). On that basis, the trust can carry on an active/trading business without being classified as a "public trading trust" (and hence a "corporate tax entity").

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> recognition of certain investment gains/losses through a shareholder equity account, rather than through the company's profit and loss statement.
>
> Accounting policies should not affect whether a company is subject to mandatory disclosure. This makes the s.3C disclosure measure capricious.

Government and the ATO appear to be aware of the risk of company restructures to avoid s.3C disclosure. The follow exchange is taken from the Senate Economics Legislation Committee transcript:

> Senator WHISH-WILSON: Are you prepared to comment on criticisms or views that private companies over $200 million are able to restructure their tax affairs so that they do not meet that threshold? Has the tax department considered how that might be policed?
>
> Mr Hirschhorn: … what I would say is that this is historic data … I do not wish to speculate as to what companies might do, but what I would say is that this data is historic data. So in a sense that behaviour is not reflected in the data which will be published in March because the company would have had to anticipate something several years in advance -

This answers the question for 2014 but not for any subsequent income years – where taxpayers were well aware of the potential application of s.3C disclosure.[25]

2.5.5 Disclosure of commercially sensitive information

The EM to the "better targeting" measure observed (at [1.17]):

> In some cases, the information to be disclosed may not otherwise be available to the private company's competition, customers and suppliers. The information may be used in commercial negotiations to the advantage of larger firms and potentially cause loss to the company.

The author is aware of at least one instance (no doubt there are others) where the s.3C disclosure of an Australian 50% private company was the only public record of that company's turnover. A competitor (a public company subject to s.3C disclosure) knew this and used that information to better understand their competitor.

Perhaps there is some merit in this from an economic perspective. However, this does not meet the stated objectives of s.3C disclosure (viz, to inform public debate and counter tax avoidance). It is also contrary to the long standing proposition that a private company's financial affairs should for the most part remain private.[26]

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[25] Senate Hansard: Economics Legislation Committee (10 February 2016) at 57.

[26] Private companies have various limitations (for example, around issuing shares to the general public) – this forms part of the trade-off when choosing between a private and public company.

2.6 Some other public tax disclosure regimes

Whilst Australia is a "world leader" in mandatory tax disclosure, we are not alone. The following countries each have their own mandatory public tax disclosure regime.

2.6.1 Denmark

From 1 July 2012, the Danish tax authorities have been able to disclose publically the following tax data:

- taxable income after set-off of losses from previous years
- losses from previous years utilised in the year
- the tax calculated for the assessment year
- the resultant tax liability.

Augmenting s.3C disclosure with similar data sets around the application of losses would go some way to explaining the situation of many "no-tax" taxpayers.[27]

2.6.2 Finland

A Finnish company's total taxable income, tax liability and outstanding tax payment/refund is made publicly available. However, this information is only available on request – rather than being mandatorily publicly disclosed.[28]

2.6.3 Norway

So called "tax lists" are made publicly available in Norway and disclose net income, net wealth/capital and assessable taxes. However, there are restrictions on promulgating "tax list" information:

- the media is allowed to see, but cannot publish a complete "tax list" – however, the media can publish data on specific companies, and can publish lists of top taxpayers
- individuals must apply for "tax list" information – and are restricted to no more than 500 requests per month.[29]

[27] PwC, "Tax Transparency and country-by-country reporting: An ever changing landscape" (October 2013) http://www.pwc.com/gx/en/tax/publications/assets/pwc_tax_transparency_and-country_by_country_reporting.pdf at 18.
[28] PwC note 27 at 18.
[29] PwC note 27 at 19.

2.6.4 Sweden

Members of the public can apply for access to the following types of information:

- details of a company's tax payments relating to direct taxes, VAT and social security contributions
- the final notice of assessment which covers the tax authority's decisions on the final corporate income tax, pension, property and yield tax for the year, as well as information regarding possible tax losses.

This information is not published on the tax authority's website, rather it is only available on request.[30]

2.7 Case study: AMP

AMP's response to s.3C disclosure provides a good example of how a taxpayer (with highly technical and specific tax issues) is dealing with the disclosure of their tax information.

The 2014 income year s.3C disclosures for AMP were:

Company name	Total income	Taxable income (TaxI)	Tax Payable (TaxP)	TaxP /TaxI (%)
AMP CAPITAL HOLDINGS LTD	664,135,038	115,565,504	34,040,100	29.46%
AMP LIMITED	30,122,634,357	4,939,066,279	375,599,394	7.60%

The issue AMP presumably would have faced was explaining the 7.6% "tax rate" to its stakeholders. This would have been particularly difficult given that AMP Limited is a tax consolidated group comprising various banking, life insurance and wealth management businesses. A stakeholder (uninitiated in taxation – let alone the mystery and wonder of life insurance taxation!) would be forgiven for asking why the "tax rate" is not much closer to 30.00%!

In response, on 10 December 2015 (i.e. just over a week before the s.3C disclosure release) AMP issued an addendum to its 2014 tax report.[31] The addendum pre-empted the s.3C disclosure by providing the s.3C disclosure tax data and observing that this produced a 7.6% number for AMP Limited (and 8.10% for the two tax consolidated groups combined).

The addendum then sought to explain the low "tax rate" in a number of ways.

There are numerous complicated reasons why this was the case. In the author's view, the addendum explained those reasons extremely well, and in a way that the public could begin to grapple with.[32]

[30] PwC, note 27 at 19.
[31] AMP, 2014 tax report addendum – tax transparency.
[32] In particular, there is a bar diagram on page 2 of the addendum which explains the "gap" between 8.1% and 30%. In short, concessionally taxed complying superannuation class income, franking credits, R&D tax offsets and foreign tax credits explained this "gap".

There was not much press around AMP's numbers – either positive or negative. It is difficult to know how the media may have reacted absent AMP "pre-disclosure". However, given the scrutiny and media commentary associated with disclosing companies that had similarly low headline "tax rates", it is likely that AMP's strategy to get on the front foot prevented misunderstanding and misleading reporting as to whether AMP is paying its "fair share".

2.8 Speculating the future of s.3C disclosure

Section 3C, in its current form, represents a compromise between various competing political ideologies. For that reason, in the author's view, it is likely to remain part of Australia's tax transparency framework for some years.

In the author's view, s.3C disclosure is an early (and clumsy) step in the trend towards greater public tax transparency. For public companies and many Australian 50% private companies, its relevance should diminish as those companies make further more detailed "voluntary" (at least in name) public tax disclosures under the Tax Transparency Code.

For some Australian 50% private companies without a public presence, s.3C will continue to be an annoyance. That annoyance will either be ignored, managed publicly or managed privately (possibly through restructures and other means), to ensure that the $200 million threshold is not triggered.

3 Tax Transparency Code

3.1 Introduction

A voluntary tax transparency code (**TCC**) appears to be the next step in the trend towards greater *public* tax transparency. The step after that may well be making the TCC mandatory – but we will come to that later.

On 12 May 2015, the then Treasurer Joe Hockey MP asked the Board of Taxation (**Board**) to develop a code for greater tax transparency. The terms of reference included the following statements:

- 1. The Board is requested to develop a voluntary code for the increased public disclosure of tax information by businesses, particularly large multinationals, by May 2016.
- 2. The actions of a few businesses, particularly large multinationals engaging in aggressive tax avoidance, have tarnished the reputations of many businesses that are doing the right thing.
- 3. Some large businesses have responded by releasing detailed information about their tax affairs. The Government would like more large businesses to publicly disclose their tax affairs to highlight those that are paying their fair share and encourage all businesses not to engage in aggressive tax avoidance.
- 5. Australia already has laws that mandate public disclosure by large companies … A voluntary code for greater disclosure will help build confidence in the majority of Australian businesses that do the right thing.

The Board undertook face-to-face industry consultation before issuing a paper for further formal consultation on 11 December 2015 (**Consultation Pape**r).[33] The key points from the Consultation Paper are briefly summarised in section 3.2 below.

The Board invited submission on the Consultation Paper. The Board received some 19 submissions. Some of the points raised in several of those submissions are summarised in section 3.3 together with some further observations.

Submissions closed earlier this year. The Board provided the Government with its final report in February 2016 (**Final Report**).[34] The Government released that report on 2 May 2016 (Budget night).

The Final Report confirms the Board's recommendations in the Consultation Paper. Accordingly, this section focuses on the Consultation Paper and the responses thereto.

[33] Board of Taxation, "A tax transparency code: Consultation Paper" (December 2015).
[34] Board of Taxation, "A tax transparency code: A Report to the Government" (February 2016).

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3.2 Summary of Consultation Paper key points

3.2.1 Potential users of TTC disclosures

The TTC should be designed to meet the information needs of:

- “general users” (the person in the street and the community at large) – best served by a simplified, standardised disclosure focusing on the tax contribution of a business to Australia
- “interested users” (shareholders, analysts, investors, social justice groups, the media and politicians) – that require more detailed information about a business’s tax affairs, through improved tax disclosures and more information about international dealings and tax paid.

The TTC should not be specifically designed to meet the needs of revenue and regulatory authorities.

3.2.2 Who should disclose?

The TTC should apply to companies and entities taxed like companies.[35] Reporting entities are bifurcated between “large business” and “medium business”. A “large business” has “TTC Australian turnover” of over $500 million. A “medium business” has “TTC Australian turnover” of $100 million to $500 million.

The calculation of “TTC Australian turnover” depends on whether a taxpayer is an Australian headquartered entity or a foreign multinational:

- For an Australian headquartered entity, “TTC Australian turnover” is the turnover of the Australian tax consolidated group. As turnover is an accounting concept, this should pick up turnover from the overseas operations of the Australian group.
- For foreign multinationals, “TTC Australian turnover” is the turnover of the accounting consolidated group “to the extent that the turnover relates to any Australian entities or Australian permanent establishments.

3.2.3 What disclosures should be made?

The Board proposes two levels of disclosure:

- **Part A: Improvements to financial statements:** This would apply to “medium business: and “large business” taxpayers and would include:

[35] Presumably, “corporate tax entities” – consistent with s.3C disclosure. The Consultation Papers reasons *“[m]ost large businesses in Australia operate through company structures or through entities that are treated as companies for Australian tax purposes.”*. Refer to the Consultation Paper at 11.

    - expanding disclosure to include a reconciliation of accounting profits to income tax expense, and from income tax expense to income tax paid/payable – including disclosing material temporary and permanent tax differences
    - disclosure of an Australian accounting effective tax rate (**ETR**) and a global ETR for the worldwide accounting consolidated group – based on a common definition of an ETR, to be developed by the Australian Accounting Standards Board (**AASB**).
- **Part B: 'Taxes paid' report:** This would apply to "large business" taxpayers only and would include a corporate tax entity's:
    - total tax contributions – including obviously corporate income tax but also optionally other Government imposts, such as PRRT, royalties, GST and State taxes, etc.
    - tax policy, tax strategy and governance – including the corporate tax entity's approach to tax risk management, appetite for tax risk and tax planning
    - *qualitative* information regarding international related party dealings.

Importantly, the Board considers that the TTC should not include disclosure of:

- *quantitative* information regarding international related party dealings[36]
- disputes with revenue authorities
- sales of goods or services made by foreign multinationals to Australians.[37]

3.2.4 How should TTC disclosures be made?

The Consultation Paper recommended that Part A disclosures *"be delivered by improvements to tax disclosures in financial statements (Part A…) and/or preparation of a taxes paid report (Part B…) as relevant…".*

The Final Report recommended a more agnostic approach - suggesting that:

- Part A disclosure could be made in the business's Australian general purpose financial reports or via publication of a 'taxes paid' report or some other document
- Part B disclosure should be made in a taxes paid report – remarking that the public is likely to find a taxes paid report more accessible than financial statements.

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[36] The Consultation Paper explains this as follows: *"… the Board considers the disclosure of this information, apart from raising issues of commercial sensitive, may not be meaningful to the intended users of the TTC."* Refer to the Consultation Paper at 16.

[37] This last point is getting at the concern addressed by the recently enacted multinational anti-avoidance legislation: that foreign multinationals can sell goods or services in Australian whilst having limited or no taxable presence in Australia – such that profits on those sales escape Australian taxation. Refer to the Consultation Paper at 17.

Furthermore, the Final Report notes that companies could satisfy the minimum standards of the TTC by including the required Australian TTC disclosures in other disclosure documents – such as the EU Directive on tax transparency, the EITI (refer section 3.5.3) or the Dodd-Frank transparency measure.

3.2.5 Other matters

The Board considers that the TTC disclosures should not be mandatorily subject to audit. The Board reasons that much of the information would already be subject to some kind of internal or external audit/assurance procedure. In this regard, the Consultation Paper states:

> Additional oversight or penalties for misleading disclosure of TTC information are not recommended. It is expected that the "taxes paid" report will be signed off by senior management in the organization, and there would be significant impacts on the reputations of businesses that are found to have made misleading disclosures.

This position was reiterated in the Final Report.

The Board does not prescribe a particular format or template for the publication of TTC material.

The Board recommends that the ATO or another government agency be appointed the responsible agency for the administration of TTC – including, maintaining a website with links to all of the TTC disclosures.

The Consultation Paper suggests that the TTC should be in operation in time for the reporting period for the 2015-16 financial year. This timing was refined in the the Final Report: *"The Board considers that the TTC should be adopted by businesses for financial years ending after the Government release of the TTC"*. So, for most taxpayers this will continue to be the financial year ended 30 June 2016. Presumably this change from the Consultation Paper was done in response to concerns the measure could otherwise be retrospective.

3.3 Summary of Submissions

Some 19 submissions were made in response to the Consultation Paper. Submission authors included (to name but a few):

- industry bodies: Australian Financial Markets Authority (**AFMA**), Corporate Taxpayers Association (**CTA**), the Minerals Council of Australia (**MCA**) and the Property Council of Australia (**PCA**)
- professional bodies: The Tax Institute
- advisers: EY, Greenwoods, KPMG and PwC
- taxpayers: BHP Billiton and Brambles

3.3.1 Key points

Set out below are some of the key points from the submissions reviewed by the author:

Issue	For e.g. refer submission by
Who should disclose: Stakeholders generally support the "medium business" and "large business" classifications. However, many stakeholders recommend a $200m (not $100m) threshold apply to Australian 50% private companies to align with s.3C disclosure.[38]	CTA Greenwoods KPMG[39] PwC,
Extent of disclosure: Stakeholders generally support the Part A and Part B bifurcation and extent of disclosure in respect of each.	CTA[40] PwC
Assurances and penalties: Stakeholders support the recommendation that there be no separate assurance requirement or penalty regime.[41]	CTA Greenwoods MCA
Related party dealing disclosure: Stakeholders support the recommendation that only *qualitative* information be disclosed. Others are opposed to this disclosure completely.[42]	CTA[43] EY[44] Greenwoods PwC[45] MCA PCA[46]
Section 3C disclosure interaction: Stakeholders recommend exemption for companies complying with TTC.	CTA[47] Greenwoods
ETR: Stakeholders support the development of an Australian and a global ETR by the AASB – rather than disclosure of the ETR (per current ATO methodology).	CTA KPMG

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[38] Grant Wardell-Johnson observes that the $200 million political compromise passed through Parliament after Board would have prepared the Discussion Paper. This may well explain why the Board did not recommend this threshold for Australian 50% private companies. Refer to Wardell-Johnson G, "Tax transparency: An Australian Perspective" (presented at The Tax Institute, Financial Services Conference, Surfers Paradise, 17-19 February 2016) at 40. The Final Report did not accept this submission.

[39] KPMG observed *"… given the Parliament has chosen a different threshold in relation to the [s.3C disclosure], the Code should follow suit."*

[40] CTA suggested a closer alignment of the tax policy/strategy disclosure with the proposed UK HMRC tax strategy disclosure. CTA observed: *"[a]lignment with the HMRC legislation would also address our concerns around Australia's transparency code being out of step with other jurisdictions, at least in the context of tax strategy and tax policy."*

[41] This Recommendation infuriated "tax activists" such as the Tax Justice Network – who suggested the recommendations are *"currently so flawed, the code should be abandoned as it will serve no useful purpose"*. Cited in Mather J, "Voluntary tax code 'so flawed it's useless'" *Australian Financial Review* (3 March 2016).

[42] For example, the MCA consider the disclosure of *"qualitative information on 'key categories' of related-party dealings, their nature and the jurisdictions of related parties would require a significant amount of detail that goes well beyond what any other transparency code currently requires"*.

[43] CTA suggested there should be a materiality threshold.

[44] EY observe that *"information about international dealings without also including information about taxes paid in other jurisdictions is likely to be misleading … Information about taxes paid in other jurisdictions could be included, but this substantially increases the burden on the company reporting due to, for example: differences in timing of tax payments in different jurisdictions and the need to obtain information from overseas related entities."*

[45] PwC observed that disclosing Advanced Pricing Arrangements (**APA**) *"may be used for benchmarking across industries 'acceptable' profit levels"*. This could result in ATO reluctance to issue APAs *"due to the fact that public scrutiny may give a misleading view of the ATO's attitude to transfer pricing issues relevant to other industry participants or taxpayers".*

[46] PCA observe that the disclosure of individual related party transactions or country-by-country reporting *"would provide commercially-sensitive information to competitor companies"*.

[47] CTA observed that Australia will be the only country to require qualitative data regarding international related parties.

Commencement date: Stakeholders generally opposed to 2015-16 financial year start date. Generally stakeholders suggest a one year deferral.	CTA Greenwoods KPMG.[48] PCA

3.3.2 Leading the world in tax disclosure!

Several of the submission observed that Australia is already a world leader in transparency and that the TTC would further this position – consequently, caution is needed. For example, Greenwoods observe:

> The Board should take the opportunity to remind the Government that Australia is already much more ambitious in the public disclosure of corporate tax information than other most countries are (or are like to be, even after implementing all of the BEPS recommendations), and Australia should therefore, be very cautious in venturing too far down this path while ever our main competitors continue to be unwilling to adopt similar practices.

Later their submission remarks:

> We doubt the claim that, 'the Government's commitment to implementing the TTC reflects an international trend of countries mandating or encouraging increased transparency of tax information' [page 1]. While it may be strictly correct that, 'a number of other countries and organisations are also *looking at* increasing the transparency of tax information of large businesses' [page 5] it is most certainly ***not*** the case that they have done much beyond looking.

Greenwoods' submission then cites the delay in implementing the UK's corporate tax transparency proposal and the hostility of the US Congress towards US Treasury efforts to push country-by-country reporting – discussed below. It also observes that the TTC goes well beyond the positions that countries were prepared to accept as part of the BEPS project.

The MCA's submission observed:

> The code goes further than existing and proposed measures internationally on a number of elements and, as such, will be more onerous for businesses operating in Australia. In particular, the proposed disclosure requirements for large companies on related-party dealings would impose onerous compliance costs, provide demands for disclosure on matters of questionable relevance and go beyond what other transparency codes require. Further, account needs to be taken of other existing and proposed transparency initiatives, many of which apply specifically to the resources industry.

In response to this concern, the Final Report observes:

> The TTC is more advanced and more comprehensive than existing tax transparency measures from other countries and organisations. However, due to the flexibility in the TTC the Board has received strong support from businesses and associations and expects it to be widely adopted.

3.3.3 Disclosure of *qualitative* related party dealings

As noted above, some of the submissions were completely opposed to the release of qualitative related party dealings. For example, the MCA observed that the disclosure of:

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[48] KPMG observed the TTC should apply to the first income year after formal Government endorsement of the TTC. A submission that the Board did accept!

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> qualitative information on ‘key categories’ of related-party dealings, their nature and the jurisdictions of related parties would require a significant amount of detail that goes well beyond what any other transparency code currently requires.

On this issue, the Final Report remarked:

> The Board acknowledges the risks of businesses publicly disclosing the information noted above, including the risk of reputation damage caused by misunderstanding of this information. However, the Board believes it is necessary for the TTC to include this information in light of community concern and media coverage of tax issues. Businesses may address these risks by carefully explaining the commercial context of these arrangements.[49]

3.3.4 Australian 50% private companies

Several submissions recommended that the threshold for TTC Part A disclosure for Australian 50% private companies be $200 million – to align with the s.3C disclosure political compromise. The Board did not embrace that recommendation.

Australian 50% private companies now face a predicament. If, as the author anticipate, over time TTC disclosure becomes a social norm, then such companies will face pressure to prepare a tax report (to embellish their s.3C disclosure). For companies without a public presence (this serves to exacerbate their practical difficulties for them making public disclosures (refer to section 2.5.1).

3.4 Some further observations

The author has had the benefit of a discussion with Dr Fiona Martin (a member of the Board’s Working Group) in early 2016. Some of the broad points/principles that came through from that discussion are set out below.

- The Working Group was generally impressed by the quality of disclosure already being made by many Australian companies.
- Having regard to the extent of disclosure already out there, the Working Group was generally unsympathetic towards stakeholders arguing that tax disclosure was administratively “all too hard”.
- If the Board failed to devise a rigorous voluntary code, then it was understood that the Government would introduce a mandatory code.

These issues are further discussed below.

3.4.1 Shining examples

The Consultation Paper states:

[49] Final Report at 21.

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> Some businesses have responded to calls for greater transparency by disclosing more qualitative and quantitative information through 'taxes paid' and CSR reports. Examples include the 'taxes paid' reports issued by Rio Tinto, BHP Billiton, AMP and Cochlear.[50]

It seems that, if several of Australia's largest companies can do it, then others should be able to follow suit.

3.4.2 Voluntary or mandatory?

Grant Wardell-Johnson observes that the word "voluntary" only appears a handful of times in the Consultation Paper.[51] He remarks:

> This is not without accident. It is clear that the code could easily be converted into a mandatory code without a change to the underlying rationale or the framework by the addition of a few sentences.

This observation holds true for the Final Report.

The interim report of the Senate Economics Reference Committee Inquiry into Corporate Tax Avoidance recommended that a mandatory TTC be introduced.[52] Specifically, Recommendation 3 states:

> The committee recommends that a mandatory tax reporting code be implemented as soon as practicable but no later than the current timeframe for the proposed voluntary public transparency code. Any Australian corporation or subsidiary of a multinational corporation 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.

Readers would be aware that this Committee is not "controlled" by Government Senators. In this regard, the Government Senators' dissenting report stated:

> It is the view of Government Senators that a voluntary disclosure code will strike a better balance between the need for transparency and the privacy and competitiveness concerns of business.[53]

Adopting a *voluntary* TTC would of itself be a large step in the trend towards greater public tax transparency. A move to a *mandatory* TTC would be an even larger one.

In the author's view, a *voluntary* TTC should be embraced because:

- having regard to the "shining examples", disclosure of reasonably basic tax information into a form that the general public can readily comprehend appears feasible

[50] Some of these examples, including what is actually disclosed, are discussed in section 3.5 below.
[51] Wardell-Johnson, note 38 at 41.
[52] Part 1 of the Report on Corporate Tax Avoidance was released on 18 August 2015.
[53] Also refer to Chenoweth N, "Coalition thinks corporate tax disclosure just about right", *Australian Financial Review* (19 August 2015).

- the deficient s.3C disclosure means that many companies are needing to clarify public misinformation and misunderstandings regarding *why* they pay how much tax they pay – and whether that amount constitutes their "fair share".

Whether the TTC should eventually become mandatory is less clear. It will depend on whether other countries adopt comparable tax transparency regimes – and the level of participation in those regimes. The impact of country-by-country (**CbC**) reporting (especially if CbC reporting ultimately becomes mandatorily publicly disclosed will also impact this.

On 9 May 2016, the Corporate Tax Association issued a medial release encouraging its members to adopt the TTC. In this regard:

> The CTA and its members strongly support the view that all large companies must meet their tax obligations in a timely and transparent manner and that they should pay their appropriate share of tax. … The TTC will provide interested users and the general public with quantitative data on income tax expense and income taxes paid or payable as well as important qualitative information on the way in which large companies approach tax strategy and governance. Adopting the TTC will also further demonstrate to the public that large companies are committed to being transparent in their tax affairs.

It is likely that a substantial uptake of a *voluntary* code will mean (at least for now) that the TTC need not be made mandatory.

3.5 Examples of voluntary public tax disclosure

A number of large Australian companies already produce comprehensive taxes paid reports as part of their corporate social responsibility agenda. The disclosures of two of these "shining examples" is outlined below, before briefly mentioning the Extractive Industries Transparency Initiative.

3.5.1 AMP

AMP has issued a Tax Report for the year ended 31 December 2015.[54] The report deals with the taxation affairs of the AMP Limited and AMP Capital Holdings Limited income tax consolidated groups. The Tax Report:

- states AMP's *"approach to paying tax is predicated on integrity and transparency"*
- provides an overview of AMP's corporate structure – including that it generally establishes a local (taxable) entity in each jurisdiction that it operates
- explains AMP's "tax strategy and governance" – which includes a tax risk framework and supporting governance processes, and includes, for example, the escalation of certain key risks that are outside of parameters approved by AMP's Board

[54] AMP, *Tax report for the year ended 31 December 2015* (published 24 March 2016).

- observes that as part of managing a global investment portfolio, AMP uses a variety of structures and entities to enter into an offshore market – in this regard:
  - *“[t]he selection of a particular location requires balancing various commercial, legal, investor and cost (including tax) factors”*
  - *“AMP’s public financial reports clearly disclose any ‘differences in overseas tax rates’ to highlight the impact of the different tax rates applied in relation to shareholder profit from offshore activities”*
- provides a summary of taxes paid for the 2014 and 2015 financial years – dissected by corporate income tax, employer/payroll taxes, insurance duties, indirect tax net of recoveries, employee payroll taxes and customer withholding taxes
- provides a reconciliation between net profit before income tax expense and taxable income – some of the reasons why there is a difference include:
  - the impact of R&D and OBU tax incentives and franking credits received on investments
  - stripping out profit attributable to accounting consolidated group entities not in the tax consolidated group
  - *“[a] relatively small part of AMP’s operations are in jurisdictions with tax rates other than 30% (principally New Zealand where the corporate tax rate is 28%)”*
- explains why AMP’s tax does not equal 30% of taxable income – refer to section 2.7 above.

3.5.2 Rio Tinto

Rio Tinto Limited has issued a Tax Report for the year ended 31 December 2014.[55] The report:

- observes that the report is consistent with Rio Tinto’s support of the principles of the Extractive Industries Transparency Initiative – discussed below
- provides an analysis of tax payments by tax type, country and level of government
- tax contributions to governments comprised 14% of gross sales revenue
- observes:

> Rio Tinto controls 594 subsidiaries of which 20 are located in 9 countries which might be considered to be ‘tax havens’. Of these 20 subsidiaries, 2 are inactive. The remaining are subject to UK or Australia’s international tax rules or other similar international tax rules. The activities of these entities are fully disclosed to all relevant tax authorities.

[55] Rio Tinto, Taxes paid in 2014: *A report on the economic contribution made by Rio Tinto to public finances* (published March 2015): http://www.riotinto.com/documents/RT_taxes_paid_in_2014.pdf. An equivalent report for 2015 is expected to be released in June 2016.

- makes the following comments with respect to offshore marketing hubs:

> Rio Tinto locates certain of its activities in the areas of marketing, procurement and freight close to external customers, suppliers and a relevant skills base, rather than at the site of the mine or operating site. Centralising activities also delivers benefits in the form of economies of scale and skill.
>
> Our Singapore Commercial Centre centralises commercial best practice across product groups and other corporate functions such as legal and procurement. This includes centres of excellence for value-in-use analysis, pricing and contracting strategies, all with a focus on managing risk and capturing value through all market conditions. These efforts maximise the value from our business and differentiate us from our peers.

- quotes Rio Tinto's CFO, Chris Lynch:

> It is essential for tax policy and design to take into account the cyclical nature of the industry and to respect agreements under which investment of capital has already been committed.

- Provides an example of the interaction between payments to Governments and the mining lifecycle – for example:

> In the early years of the operating phase, as annual tax allowances for capital construction expenditures are higher, there will be no corporate income taxes paid. As annual tax allowances for capital construction costs are amortised, corporate income tax payments increase.

- indicates that Rio Tinto is a strong supporter of the Extractive Industries Transparency Initiative.

3.5.3 Extractive Industries Transparency Initiative

The Extractive Industries Transparency Initiative[56] (**EITI**) was established in 2003. It sets a global standard for extractive industry companies to publish what they pay to governments and for governments to disclose what they have received.[57] Payments covered include taxes, royalties and other statutory payments, including licence fees and signature, discover and production bonus payments.

The most recent EITI Standard is dated 15 February 2016. It has several objectives:

- to minimise corruption by improving the accountability of payments made to resource countries
- to maximise the accountability of oil, gas and mining companies at national and local levels.[58]

The EITI achieves this through *"a simple game of show and tell"*. In this regard, for each country:

[56] https://eiti.org/files/english_eiti_standard_0.pdf.
[57] Commonwealth Government Department of Industry, Extractive Industries Transparency Initiative *Multi-Stakeholder Group Report to Government* (May 2015) at (vi).
[58] Commonwealth Government Department of Industry, Extractive Industries Transparency Initiative *Multi-Stakeholder Group Report to Government* (May 2015) at (vi).

- extractive companies *voluntarily* disclose their tax and royalty payments made to governments in that country
- governments (that have implemented the EITI Standard) *mandatorily* reveal the taxes that they have received from those companies

and then, the above two numbers are reconciled.

Accordingly:

> The EITI data gives the public an official glimpse of actual revenue flows from local resource projects. This is information that, in many cases, has never been made public before. Any inconsistencies between the two sets of data point to lax administration or perhaps corrupt skimming of resources.[59]

The EITI is administered by a global board and a secretariat. Currently, some 31 countries have implemented the EITI and have 'compliant' status. Another 20 or so countries are currently in the implementation process and have 'candidate' status.

Interestingly, Australia is not on this list at all. Australia completed a pilot of the EITI in 2014. The Multi-Stakeholder Group (**MSG**) (comprising representatives from Commonwealth and State Government, industry and "civil society") did not recommend the full implementation of the EITI Standard. However, the MSG has recommended adoption of a "hybrid model" whereby company payments would not be annually reconciled but would be subject to spot checks in a "statistically valid sample".[60]

Despite that Australia has not signed up to the EITI Standard, many Australian companies (including Rio Tinto and BHP Billiton), operate in many of the EITI compliant countries and support the EITI in those jurisdictions.

[59] Mills S, "Why isn't Australia signing up to mining revenue transparency?" *Australian Mining* (31 October 2014).
[60] Mill S, note 59 and Department of Industry, note 58.

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4 Country-by-country reporting

4.1 Introduction

Country-by-country (**CbC**) reporting is at the heart of the global trend of greater corporate tax transparency. Australia has embraced country-by-country (**CbC**) reporting.

CbC reporting involves multi-national entities providing tax authorities with information around their global corporate structure, how and where they operate and details around their international related party dealings.

Currently, the information to be provided by CbC reporting entities to tax authorities is intended to stay private – that is, to be shared amongst other participating tax authorities but not to be made public. Nonetheless, if there is to be another major step in the trend towards greater public tax transparency, then the public disclosure of CbC reports appears to be that logical next step.

This section of the paper provides a brief overview of:

- how we got to CbC reporting – namely, BEPS Action 13
- our CbC reporting legislation
- the type of information to be disclosed,

before making some further observations regarding the rules – including commenting on the European Commission's proposal to make certain CbC reporting information publicly available.

4.2 BEPS Action 13

4.2.1 Background

The OECD and G20's Base Erosion and Profit Shifting (**BEPS**) project involves a 15-point plan designed to ensure that profits are taxed where the activities which generate those profits are performed.[61] The action items seek to address the opportunities that have *"opened up … for MNEs to greatly minimise their tax burden"* which, according to the OECD, *"has resulted in the tense situation in which citizens have become more sensitive to tax fairness issues*".[62]

The plan for Action 13 was published in 2013 and involves:

> Re-examine transfer pricing documentation

[61] EM to the *Tax Laws Amendment (Combatting Multinational Tax Avoidance) Bill 2015* at [5.6].

[62] OECD, Action Plan on Base Erosion and Profit Shifting, OECD Publishing (2013) http://dx.doi.org/10.1787/9789264202719-en.

> Develop rules regarding transfer pricing documentation to enhance transparency for tax administration, taking into consideration the compliance costs for business. The rules to be developed will include a requirement that MNEs provide all relevant governments with needed information on their global allocation of the income, economic activity and taxes paid among countries according to a common template.

Essentially, Action 13 seeks to address the frustration of tax administrators brought about because they lack a complete picture of an MNE's global operations. In this regard, Action 13 recognises that enhancing transparency for tax administrators (by providing them with adequate information to conduct transfer pricing risk assessments) is an essential part of tackling profit shifting.[63]

The OECD released its final report on Action 13 in November 2015. The final report contains revised standards for transfer pricing documentation and a template for CbC Reporting. Specifically, the final report contains a new Chapter V of the OECD's Transfer Pricing Guidelines on Documentation.

4.2.2 New "three-tier approach to transfer pricing documentation"

Chapter V provides guidance for tax administrators when developing rules/procedures regarding the types of documents to be obtained from taxpayers when addressing transfer pricing issues. In particular, Chapter V recommends that jurisdictions require multinationals to provide three key reports (referred to as "a three-tier approach to transfer pricing documentation:

- master file – a "big picture" description of the MNE group
- country file – a description of the operations in that specific jurisdiction
- country-by-country reporting – a tabular report regarding the global allocation of a multinational's income and taxes paid, together with certain indicators of economic activities, broken down by each relevant country.

Each of these reports are briefly discussed below. However, it is worth mentioning now that the significance and novelty of Action 13 lies in the proposal that CbC reports be automatically exchanged with other relevant jurisdictions. This is also discussed further below.

4.2.3 Application threshold

Chapter V states that the obligation to file the CbC report does not apply to:

> MNE groups with annual consolidated group revenue in the immediately preceding fiscal year of less than EUR 750 million or a near equivalent amount in domestic currency as of January 2015.[64]

[63] EM to the *Tax Laws Amendment (Combatting Multinational Tax Avoidance) Bill 2015* at [5.6].
[64] Refer to Chapter V of the OECD *Transfer Pricing Guidelines on Documentation* at [52].

4.3 Australia's legislative response

4.3.1 Overview

A new Subdivision 815-E was inserted into the ITAA 1997 by *Tax Laws Amendment (Combatting Multinational Tax Avoidance) Act 2015*. Evidently, the legislative intention in Subdivision 815-E is that Australia adopts the "three-tiered approach to transfer pricing" set out in Chapter V.[65] However, the way the legislation achieves this is interesting.

4.3.2 Section 815-355

New s.815-355 does most of the heavy lifting. In broad terms:

- Subsection (1) requires a taxpayer to provide certain prescribed statements to the Commissioner where that taxpayer[66] is a "significant global entity" (**SGE**) and is either:
    - an Australian resident, including a resident trust estate, or a partnership with at least one Australian resident partner
    - a foreign resident (including trust or partnership) with an Australian permanent establishment.[67]
- Subsection (2) requires the prescribed statements be provided within 12 months after the end of the period to which it relates.
- Subsection (3) prescribes the statements:

> (a) a statement relating to the global operations and activities, and the pricing policies relevant to transfer pricing, of you and … the other members of [the SGE] group;
>
> (b) a statement relating to your operations, activities, dealings and transactions;
>
> (c) a statement relating to the allocation between countries of the income and activities of, and taxes paid by you and … the other members of [the SGE] group.
>
> Note: These statements correspond to the following in Annexes I, II and III to Chapter V set out in the Guidance on Transfer Pricing Documentation and Country-by-country Reporting of the Organisation for Economic Cooperation and Development and the G20:

[65] So much is clear from the legislative note to s.815-350: "*This Subdivision enables the implementation of measures issued by the Organisation for Economic Cooperation and Development relating to transfer pricing documentation and country-by-country reporting (including Action 13 of the Action Plan on Base Erosion and Profit Shifting of the G20 and the Organisation for Economic Cooperation and Development)"*.

[66] The head company of a consolidated group will be the taxpayer for this purpose. That is, entities forming part of a tax consolidated group will report as a single entity. Refer to the EM to *Tax Laws Amendments (Combatting Multi-national Tax Avoidance) 2015* at [5.14].

[67] Per s.177A of the ITAA 1936, whether a taxpayer has an Australian permanent establishment, depends on the PE definition in the applicable treaty, or if no treaty applies, then as defined under Australian law.

(a) a statement under paragraph (a) corresponds to the master file (see Annexe I);

(b) a statement under paragraph (b) corresponds to the local file (see Annexe II);

(c) a statement under paragraph (c) corresponds to the country-by-country report (see Annexe III).

The reliance on legislative notes to tie the prescribed statements back to Chapter V is interesting. Perhaps a more direct way the draftsman could have achieved this would have been to follow the approach in s.815-235.[68]

4.3.3 Significant global entity

An SGE is defined in s.960-555 as broadly an entity that is a:

- global parent with A$1 billion or more of "annual global income":[69] or
- a member of a group of entities that are consolidated for accounting purposes as a single group and one of the other members of the group is a global parent entity with "annual global income" of A$1 billion or more.

4.3.4 Exemptions

Section 815-365 provides the Commissioner with the discretion to exempt an entity, or class of entities, from providing one or more of the prescribed statements. The Commissioner might do this where an SGE does not engage in international transactions.[70] However it is difficult to think of an example where this would not be the case!

The ATO has also indicated that it plans to exempt entities that are covered by Division 50[71] – namely, registered charities and certain other not-for-profits. Again, it is difficult to think of many examples where this exemption would apply in practice.

Importantly, the ATO has also stated that it will "most likely" provide an exemption to a local MNE entity from filing a master file and a CbC report where the foreign parent entity resides in a jurisdiction that has not yet implemented CbC reporting – and the local MNE entity is encountering difficulties in providing the required information. However, this exemption is limited to the first year of CbC reporting.[72]

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[68] That section prescribes certain "documents covered" to which regard must be had when applying Subdivision 815-C, including the OECD's Model Tax Convention on Income and on Capital, and its Commentaries thereto.

[69] Defined in s.962-565 as "the total annual income of all members of the group", or - if the entity is not part of a group, then of that entity only.

[70] LCG 2015/3: *Subdivision 815-E of the Income Tax Assessment Act 1997: Country-by-Country reporting* at [17].

[71] LCG 2015/3 at [20].

[72] LCG 2015/3 at [37].

4.3.5 Timing of implementation

Subdivision 815-E applies to income years commencing on or after 1 January 2016. Consequently, Australian MNE entities with a 30 June year end will need to lodge the CbC reporting information for their 2016-17 income year by 30 June 2018.

4.3.6 Administrative penalty

The TAA imposes an administrative penalty where an SGE fails to lodge its CbC reporting information on time. The maximum penalty is currently 30 penalty units.

On 29 February 2016, Andrew Leigh MP (ALP) introduced a private members bill[73] into the House of Representatives calling for the maximum penalty to be increased to 1,500 penalty units. That Bill also proposes a new section to require the Commissioner to consider making an examination of the affairs of an SGE that has failed to lodge its CbC report information within 308 days of its due date.

This Bill lapsed when Parliament was prorogued on 15 April 2016.

Nonetheless, the Government announced general administrative penalty increases in the May 2016 Budget. This announcement may well assuage Mr Leigh. The announcement included a proposed:

- 100 times increase in the maximum penalty imposed on SGEs which fail to lodge their tax documents
- doubling of penalties relating to statements made to the ATO for multinational companies that are reckless or careless with their tax affairs.

4.4 Specific information to be disclosed

4.4.1 Per Chapter V and the Law Companion Guide

The ATO is in the process of devising the "approved forms" for the relevant disclosures. The below table provides a high level summary based on Chapter V and ATO guidance set out in LCG 2015/3: *Subdivision 815-E of the Income Tax Assessment Act 1997: Country-by-Country reporting.*

Report	Summary and source of obligation	Provided by and to whom	Example of information to be provided
Master File	Provides overall picture of global business, TP policies and global allocation of income and economic activity.	Technically, each MNE local taxpayer (but not each TCG subsidiary member)[74] must provide the master file to the ATO. However, the ATO may	• MNE's legal and ownership structure, • geographical locations • description of SGE's overall strategy in relation to:

[73] *Tax Laws Amendment (Tougher Penalties for Country-by-Country Reporting) Bill 2016*.
[74] Noting that the single entity rule in s.701-1 should apply.

Report	Summary and source of obligation	Provided by and to whom	Example of information to be provided
	"…intended to provide a high-level overview in order to place the MNE group's transfer pricing practices in their global economic, legal, financial and tax context."	relieve the taxpayer from this requirement in circumstances where another Australian resident entity in the same MNE group will provide the master file.[75]	- intangibles, including a list of intangibles and related documents (e.g. cost contribution agreement) - group financing, including identifying related party financing TP policies • description of the MNE's products and services supply chain (refer Annex I to Chapter V)
Local file	Provides more detailed information relating to specific intercompany transactions. *"The local file focusses on information relevant to the transfer pricing analysis related to transactions taking place between a local country affiliate and associated enterprises …"*.	Each MNE local taxpayer must provide the local file to the ATO.	• description of local business and management structure and strategy • description of material "controlled transactions": purchase/provision of goods/services, loans, licences of intangibles, etc. (refer Annex II to Chapter V). Based on the LCG, the ATO proposed three alternative levels of local file disclosure – referable to the complexity of the local MNE group entity: *"aimed at balancing the cost of compliance with the information needs we required to adequately risk assess significant global entities"*.[76] However, this has recently changed following subsequent ATO consultation with industry – refer section 4.4.2
CbC report	Provides aggregate tax jurisdiction-wide information relating to the global allocation of the income, taxes paid and indicators of the location of economic activity. *"… in essence, a very large spreadsheet which shows the key financial and other metrics of a company on a worldwide basis…"*[77]	Technically, each MNE local entity taxpayer must provide the CbC report to the ATO. However, this requirement may be relieved where: • the global parent of that MNE provides the CbC report to its home tax authority • that tax authority then automatically exchanges	Comprises three tables: • Table 1: revenue, profit or loss before tax, income tax paid (on a cash and accruals basis), number of employees, etc. for each jurisdiction in which the MNE operates. • Table 2: list of entities in each jurisdiction and the main business carried on - based on a prescribed category: including R&D, Purchasing or procurement, Sales, marketing and distribution, Internal group finance and Insurance

[75] Refer to the EM to *Tax Laws Amendment (Combating Multinational Avoidance) Bill 2015* at [5.20].
[76] Refer to LCG 2015/3 at [42].
[77] Extract from Mark Konza, ATO describing CbC reporting to the Senate Economics Legislation Committee. Refer to Senate Hansard: Economics Legislation Committee (10 February 2016) at 61.

Report	Summary and source of obligation	Provided by and to whom	Example of information to be provided
		that information with the ATO.[78]	• Table 3: any further clarification of issues[79]

4.4.2 Subsequent consultation around the local file

The ATO is in the process of devising the approved forms for SGEs to make the applicable CbC statement. In particular, the ATO has consulted extensively with industry around the design of the local file.

The ATO intends to release in final the "high level design" of the local file shortly (current as of 5 June 2016). The key changes from the LCG are:

- providing two rather than three alternative levels of local file disclosure ("Short Form Local File" and "Local File") – in this regard:
    - a taxpayer qualifies for the short form if, broadly, the aggregate value of international related party dealings is less than $2 million and the taxpayer is able to apply the simplified transfer pricing record keeping requirements
    - the "Short Form Local File" requires disclosure of: qualitative information regarding the Reporting Entity's organisation structure, a description of their business, and details of any business restructures or transfers of intangibles
    - the "Local File" requires all of the above short form disclosure plus the disclosure of all controlled transactions (Part A) and further written agreements and foreign Advance Pricing Agreements and rulings for material controlled transactions (Part B)
    - transactions associated with certain specified types of activities will make a Reporting Entity ineligible to lodge only the "Short Form Local File" – specified activities include, for example, the legal or equitable assignment or use of intellectual property
- addressing industry concerns around duplication of local file and International Dealings Schedule reporting by allowing a Reporting Entity to lodge Part A of the Local File instead of completing the section of the IDS addressing international related party dealings.[80]

The final local file will be published on the ATO website shortly (current as of 5 June 2016), with instruction also to follow.

[78] Refer to the EM to *Tax Laws Amendment (Combating Multinational Avoidance) Bill 2015* at [5.20].
[79] Wardell-Johnson G, refer note 38 at 32.
[80] Part A o the Local File must be lodged by the company's tax return due date – rather than 12 months after year end, which is the due date under s.815-355(2).

The author understands that the ATO is now turning its attention to the master file (current as of 5 June 2016). The ATO has confirmed that the master file will follow the OECD format and that the ATO intends to release further information as to how the master file will need to be completed.

4.5 Exchange of CbC reports

4.5.1 MCAA

On 27 January 2016 some 31 countries[81] signed the Multilateral Competent Authority Agreement for the Exchange of Country-by-Country Reports (**MCAA**). The MCAA facilitates the automatic exchange of annual CbC reports:

> … each Competent Authority will annually exchange on an automatic basis the CbC Report received from each Reporting Entity that is resident for tax purposes in its jurisdiction with all such other Competent Authorities of Jurisdictions with respect to which it has this Agreement in effect, and in which, on the basis of the information in the CbC Report, one or more Constituent Entities of the MNE Group of the Reporting Entity are either resident for tax purposes, or are subject to tax with respect to the business carried out through a permanent establishment.[82]

Since then India, Canada, Iceland, Israel, New Zealand, China, Senegal, Nigeria, Jamaica, Uruguay and Brazil have also signed up to CbC exchange under the MCAA (current as of 5 June 2016). Given how many countries have expressed their intention to adopt CbC reporting, no doubt many more countries will follow suit.

4.5.2 Example

So, for example:

- a United Kingdom parent of a multinational would file its CbC report
- the HMRC would identify the jurisdictions listed on the CbC report – being jurisdictions specified in the CbC report as jurisdictions where that MNE has one or more “Constituent Entities”
- if Australia is listed, then the HMRC would automatically provide that CbC report to the ATO.

Furthermore, all of the Australian taxpayers in the UK MNE should generally be exempted from the requirement to lodge the CbC report again.

[81] The 31 countries comprise 23 European countries including (well at least until 23 June 2016!) the United Kingdom, as well as Australia and Japan. The United States and Canada are noticeably absent. Refer to Wardell-Johnson, note 38 at 34.
[82] Refer to Section 2: Exchange of Information with Respect to MNE Groups.

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4.5.3 Purpose

The purpose of exchanging CbC reports is pithily described by Mark Konza[83] in the following exchange with the Senate Economics Legislation Committee:

> Mr Konza: Firstly, it will require companies, under the OECD guidelines, to create and maintain certain information about their operations. Secondly, it will give us the opportunity to access that information from treaty partners. The country-by-country report … allows us to diagnose the tax plan that is actually in operation. That is going to be available to us and our treaty partners. The type of cooperation that we have been encouraging on a worldwide basis will be greatly assisted when we are able to access a fairly standardised piece of information about each company.
>
> Senator BUSHBY: The bottom line is that it is going to give you greater opportunity for exchange of information with other tax offices around the world to understand those global tax plans that were talked about earlier and then work out the consequences, in an Australian context, for what tax should be payable.
>
> Mr Heferen[84]: Yes, that is right. It is.

Described another way, CbC reporting addresses the tax authority demand for more information about the whole supply chain – not just the particular step undertake in their country.[85] This should, result in behavioural change by MNEs operating in Australia – that is, less willingness to take aggressive tax positions.[86]

Chapter V observes that the purpose of CbC reporting and exchange is not to prompt automatic transfer pricing adjustments based on income allocations between various jurisdictions.

4.6 United States' position

The United States was a notable omission from the list of MCAA signatories. However, that is not to say that the US is anti-CbC. The US Treasury issued draft regulation on 23 December 2015 to implement CbC reporting. In summary, the draft regulations provide that:

- certain US persons that are the ultimate parent of an MNE must file a CbC report with the Internal Revenue Service
- the requirement to report will be triggered by a US$850 million threshold
- the form of that CbC report will follow the OECD Action 13 recommendations/guidance
- the US will only automatically exchange with countries that have an exchange of information agreement with the US – noting the US will not enter into such an agreement unless the US has reviewed that jurisdiction's confidentiality procedures

[83] Deputy Commissioner – International, ATO.
[84] Rob Heferen, Deputy Secretary, Revenue Group, The Treasury.
[85] EY, "Are you ready for your close-up?" (2015) at 9.
[86] Refer to Regulatory Impact Statement to *Tax Laws Amendment (Combating Multinational Avoidance) Bill 2015* at [6.71] to [6.72].

- in broad terms, the "check-the-box" treatment of an entity will be respected:

> [I]t is expected that the partners will report their share of the partnership's items in the partners' respective tax jurisdictions of residence in order to determine the aggregate amounts to be determined on Form XXXX, Country-by-Country Report…[87]

- the measures will apply from an MNE's income year commencing on or after when the regulations are published as final in the Federal Register.[88]

Whether the IRS has the authority to require CbC reporting has been the topic of some debate. In this regard, Senate Finance Committee Chairman, Chris Hatch, and House Ways & Means Committee Chairman, Paul Ryan, wrote a letter to the Secretary of the Treasury, Jacob Lew on 9 June 2015 that observed:

> Congress is tasked with writing the tax laws of the United States, including those associated with cross-border activities of U.S. companies. Regardless of what the Treasury Department agrees to as part of the BEPS project, Congress will craft the tax rules that it believes work best for U.S. companies and the U.S. economy. …
>
> We are troubled by some positions the Treasury Department appears to be agreeing to as part of this project. For example, we are concerned about the country-by-country (CbC) reporting standards that will contain sensitive information related to a U.S. multinational's group operations. We are also concerned that Treasury has appeared to agree that foreign governments will be able to collect the so-called "master file" information directly from U.S. multinationals without any assurances of confidentiality or that the information collection is needed.[89]

Nonetheless, it appears that the US will implement CbC reporting. Indeed, current as of 4 May 2016, the US is working on *optional* CbC reporting to cover the "gap year" 2016 in which US multinationals are not yet required to lodge CbC reports, but their subsidiaries in a number of countries are so required.[90]

4.7 Some further observations

4.7.1 Compliance burden

The Regulatory Impact Statement to the Bill that introduced CbC reporting observes that affected taxpayers: *"are quite sophisticated and the majority of information required to be completed in the reports will be relatively simple to extract once appropriate systems are in place"*.

In practice, whilst an SGE is likely to be "sophisticated" that does not necessarily equate to sophisticated accounting systems – or, more particularly, agile accounting systems that can quickly be

[87] KPMG, "KPMG report: Country-by-country reporting proposed regulations in United States" (24 December 2015) https://home.kpmg.com/xx/en/home/insights/2015/12/tnf-kpmg-report-cbyc-proposed-regulations-united-states.html.
[88] TP Tuned, "United States – Country-by-country reporting proposed (update)" (updated 8 May 2016) http://www.tptuned.com/news/united-states/united-states-country-by-country-reporting-proposed/.
[89] United States Senate Committee on Finance, Chairman's News http://www.finance.senate.gov/chairmans-news/hatch-ryan-call-on-treasury-to-engage-congress-on-oecd-international-tax-project (originally cited in Greenwoods submission in response to the Consultation Paper).
[90] TP Tuned, note 88.

modified to spit out additional information in a new format. Instead, modifications are complicated, labour intensive and expensive.

The new CbC reporting requirements (especially the local file) necessarily overlap the existing reporting requirements in:

- Subdivision 284-E regarding transfer pricing documentation
- the International Dealings Schedule.

The ATO is aware of this overlap and states in LCG 2015/3 that *"[f]urther guidance will consider any overlap … to address the issue of how we will most efficiently administer these distinct obligations"*.[91] As noted in section 4.4.2 above, now has a proposal to address this duplication.

As noted in section 4.4.2 above, the ATO has now proposed a solution to this overlap.

4.7.2 Interpretation issues

Whilst the OECD has provided comprehensive guidance on the implementation of CbC reporting, there are differences (sometimes only subtle ones) as between each jurisdiction's CbC implementation.It is unclear who (which tax authority or OECD) will be the final arbiter on the way terminology within the CbC reporting framework should be interpreted and applied.

4.7.3 Intragroup dealings

MNEs are grappling with the way that intragroup dealings should be disclosed.

For example, an MNE with entities in a particular jurisdiction may well have transactions between those entities. Should Table 1 of the CbC report just aggregate the turnover of each entity in that jurisdiction (which would include intragroup revenues) or should all of the entities within the same jurisdiction be consolidated (i.e. intragroup transactions eliminated) for CbC report purposes?

4.7.4 Data security

Section 5 of the MCAA provides that all information exchanged is subject to the confidentiality rules and other safeguards provided for in the Convention on Mutual Administrative Assistance in Tax Matters.

Where a CbC report is exchanged with multiple jurisdictions, then the risk of private information becoming public or being "leaked" inevitably increases.

[91] See generally LCG 2015/3 at [53].

4.7.5 Country-to-country disputes!

There are likely to be more disputes between tax authorities – as they realise how much the other is collecting from an MNE considered to “belong” in that jurisdiction. . .

4.7.6 Paramountcy of accounting standards

As noted above, the entry point into CbC reporting is being an SGE – determined by applicable accounting standards. Consequently, an Australian entity connected to a foreign MNE is unlikely to be subject to CbC reporting where accounting standards do not consolidate the Australian entity to the MNE accounting group. Whether that Australian entity is or is not consolidated depends on the particular accounting standard applied in the relevant jurisdiction.

The accounts should reflect what the ultimate shareholders of the group economically own. However, CbC is based on consolidatable entities, which under the accounting standards, is dependent on very broad concepts of control (not necessarily economic ownership).

For example, an MNE may have a fairly small (seed/sponsor capital) investment in a collective investment vehicle (**CIV**) and also be the investment manager for that CIV. Accounting standards may well treat that MNE as controlling that entity. In this instance, the accounts do not reflect MNE’s economic ownership in that CIV.

In many cases, the tax liability on CIV income will be borne at the investor level. Consequently, the CbC report would disclose substantial income but little tax paid for that CIV. This provides a misleading impression regarding how much tax the MNE is paying and its effective tax rate.

Even if the CIV is not consolidated for accounting purposes, then will management fees paid by the CIV to the MNE need to be disclosed as a related party transaction (given the MNE’s seed/sponsor capital)?

4.8 Public disclosure of CbC information – the next logical step?

4.8.1 Overview

The public disclosure of CbC reporting information seems to be the next logical step in the trend towards greater tax transparency. Indeed, many stakeholders have long anticipated that CbC reporting will become part of the suite of public tax disclosures.

The European Commission’s recently announced proposal confirms this – discussed below.

4.8.2 EU proposal – some background and context

In July 2015 the European Parliament recommended changes to the EU accounting directive and transparency directive to require large groups and public interest entities to include CbC information in the notes to their financial statements. This recommendation followed a European Parliament study that estimated EU member countries lose EUR 50 to 70 billion each year due to “aggressive corporate tax planning”.[92]

In March this year, a leaked European Commission draft proposal document called for the public disclosure of CbC reporting information. The proposal argued that the “enhanced public scrutiny” of MNEs tax arrangements provided by public CbC reports is necessary to promote corporate responsibilities, social welfare through tax revenue, fair competition between large and small enterprises and informed democratic debate.[93]

On 12 April 2016 the European Commissioner officially released the proposal for the public disclosure of CbC reporting information.[94] It appears that the proposal is intended to respond to the European Parliament’s recommendation.[95] An accompanying EC fact sheet states:

> Today’s proposal will respond to the intense public demand to combine openness on company accounts and the level of corporate income tax actually paid with the need to safeguard the competitiveness of EU businesses. In our proposal, we will pay particular attention to tax information relating to countries that do not respect good governance standards.

4.8.3 EU proposal – some specifics

The EC proposal does not simply call for the public release of the Chapter V CbC report. However, its scope is similar: MNEs with EUR 750 million of annual total consolidated revenue are within the scope of the rules – some 6,500 companies. The proposed measure applies to both EU parented MNEs and to the subsidiaries of non-EU parented MNEs.

The proposed measure calls for the public disclosure of information contained in the CbC report – rather than necessarily the master file or local file. In summary, under the EC proposal:

- information is segregated between the MNE’s activities in:
    - each EU Member State
    - each “tax haven” jurisdiction – described as *“jurisdictions that do not abide by tax good governance standards”*[96]

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[92] European Parliamentary Research Service, “Bringing transparency, coordination and convergence to corporate tax policies in the European Union” (September 2015).

[93] Finley R, “European Commission Calls for Public CbC Reporting” *Tax Notes International* (28 March 2016) at 1068.

[94] Refer to http://ec.europa.eu/finance/company-reporting/docs/country-by-country-reporting/160412-factsheet_en.pdf for a fact sheet explaining the European Commission’s concerns.

[95] KPMG, “European Commissioner proposes public reporting for country-by-country reporting for multinationals” *Luxembourg Tax Alert 2016-08* (April 2016). http://www.kpmg.com/LU/en/IssuesAndInsights/Articlespublications/Pages/LuxembourgTaxAlert2016-08.aspx?utm_source=Mondaq&utm_medium=syndication&utm_campaign=View-Original.

[96] These jurisdictions will be included on a ‘Common Union list’ and will consist of jurisdictions which do not comply with principles for transparency and exchange of information, fair tax competition, standards set by the G20 and/or the OECD or other relevant standards.

    - the rest of the world
- the information to be disclosed includes:
    - brief description of activities
    - number of employees
    - net turnover – including related party turnover
    - profit or loss before tax
    - tax accrued and paid
    - accumulated earnings.

The information would be published in a business register. The MNE would also be required to publish the information on the MNE's website for at least five years.

The European Commission proposal is just that at this stage. To become law it must be approved by the finance ministers of the Member States in the ECOFIN Council and the European Parliament. It remains to be seen whether this will happen.

4.8.4 Some further observations

If the EC proposal is adopted, then most (if not all) of Australia's MNEs would be affected. That is, Australian MNEs with A$1 billion turnover or more would invariably have one or more European subsidiaries.

Once the detail of the activities of subsidiaries in EU Member States and EU prescribed "tax havens" are reported on a country-by-country basis, then it is no large step for the EU, the OECD, Australia or other jurisdictions to require public country-by-country reporting for the rest of the world.

The public disclosure of CbC report information presents some challenges:

- **Tax data absent context**

  We have observed with other mandatory public disclosure regimes that taxpayers typically need to produce and publish separate information to explain the mandatorily disclosed data – for example, refer to the AMP case study in section 2.7 above.

  The CbC report is essentially a table of data – that data set is difficult to comprehend absent some context. This is presumably why the OECD requires a master and local file to accompany the CbC report.

  Only publicly disclosing the CbC report has the potential to mislead. In response, MNEs with "bad" tax metrics would need to produce further material to explain themselves. To that end, publicly disclosing the master and country files is an option. However, given the commercially sensitive information expected to be included in these reports, this may well not be appropriate.

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- **Reconciling with other publically available information**

  Inevitably, the veracity of information made publicly available by an MNE would be tested. An obvious starting point would be to compare publicly disclosed tax data against an MNE's audited financial statements.

  Consequently, once tax data is made publicly available, companies may well find themselves having to provide reconciliations to financial statements. Reconciliations could be on a:

  - country-by-country basis - comparing the tax data to accounts prepared in each jurisdiction
  - consolidated group basis – comparing aggregate tax data against global consolidated financials

  or all of the above.

Finally, the Board of Taxation is against public disclosure of CbC information:

> … it should be noted that Country-by-Country reporting is designed as a risk management tool for revenue authorities rather than a public disclosure regime. The Board recommends against any component of the OECD Country-by-Country reporting being made the subject of mandatory public disclosure under the TTC.[97]

[97] Board of Taxation, Final Report at 21.

5 Common Reporting Standard

5.1 Introduction

The Common Reporting Standard (**CRS**) is an OECD led framework to tackle and deter cross-border tax evasion. In summary:

- the CRS creates an international standard of due diligence and reporting rules for Financial Institutions to identify the accounts of foreign tax residents
- the Financial Institution collects certain information regarding the foreign tax resident account holder and then reports that information to its local tax authority
- the local tax authority then shares that information with the relevant foreign jurisdiction's tax authority
- reciprocally, the reporting tax authority will receive similar information from foreign tax authorities regarding financial accounts held by residents in the first mentioned jurisdiction.

Australia has implemented the CRS by:

- signing the Common Reporting Standard Multilateral Competent Authority Agreement on 3 June 2015 – to facilitate the exchange of CRS information
- introducing domestic law - to require Financial Institutions in Australia to provide information to the Commissioner in accordance with the CRS.

5.2 What exactly is the CRS?

The OECD has produced a document entitled "Standard for Automatic Exchange of Financial Account Information in Tax Matters".[98] This is colloquially known as the CRS. However, the standard itself is in Part II.B of this document. This document also contains commentary on each section of the standard itself – similar to the OECD tax treaty commentaries.

CRS concepts and procedures are drawn extensively from the Foreign Account Tax Compliance Act (**FATCA**). There are *similarities* between Australia's version of FATCA (under Australia's Intergovernmental Agreement with the US) and CRS. However, the scope, due diligence and reporting requirements are not the same – meaning that CRS implementation cannot be simply rolled out by FATCA compliant Financial Institutions.

[98] This document was approved by the Council of the OECD on 15 July 2014.

5.3 Australia’s legislative response

The *Tax Laws Amendment (Implementation of the Common Reporting Standard) Act 2016* received Royal Assent on 18 March 2016. This Act inserts a new Subdivision 396-C into Schedule 1 of the TAA. In particular, s.396-105 provides that a “Reporting Financial Institution” (**RFI**) that is a resident in Australia or has an Australian permanent establishment that maintains one or more “Reportable Accounts”:

> … must give the Commissioner a statement that contains in respect of the account the information that the *CRS states the entity must report.

The term “CRS” is defined in new s.396-110(1) by direct reference to Part II.B of the document noted in section 5.2 above.

In April 2016 the ATO issued material regarding the implementation of FATCA and the CRS.[99] The material provides some useful guidance around the practical implementation of these Automatic Exchange of Information (AEOI) initiatives.

5.4 Key concepts

The terms Reportable Financial Institution, Reportable Account, Reportable Person and Reportable Jurisdiction as they apply under Australian law are defined in the CRS.

5.4.1 Reportable Financial Institution

The term Reportable Financial Institution is defined in Section VIII of the CRS to generally include depository and custodial institutions, investment entities and certain types of insurance companies (Specified Insurance Company).

Accordingly, banks and other Financial Institutions are within the ambit of the CRS rules. Brokers that hold financial assets on behalf of others, and other non-depository investment banks will also generally be covered.

A number of entities are specifically exempted from the CRS – they are classified as Non-Reporting Financial Institutions. These include government entities, international organisations or Government central banks.

5.4.2 Reportable Accounts

An RFI must maintain one or more Reportable Accounts to be required to report to the Commissioner. Subsection 396-105(3) provides:

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[99] ATO, “Automatic exchange of information – guidance material” (April 2016) https://www.ato.gov.au/General/International-tax-agreements/In-detail/International-arrangements/Automatic-exchange-of-information---guidance-material/.

> Whether an entity maintains a Reportable Account (within the meaning of the *CRS) must be determined by the entity by applying the due diligence procedures described in the CRS.

Subsection 396-120(5) provides that an account maintained by an RFI will be a Reportable Account if all of the following apply:

- the RFI does not apply the due diligence procedures described in the CRS in relation to the account
- the CRS does not state that the account is not required to be identified
- the account would be such a Reportable Account if the RFI applied those procedures.

In a sense, there is a presumption that an account is reportable, unless through the due diligence process (discussed below), this is demonstrably not so.

5.4.3 Reportable Person

Generally, a Reportable Person is an individual or entity that is a resident in a Reportable Jurisdiction (under the laws of that jurisdiction – rather than, say, under an applicable tax treaty).

Some 101 jurisdictions have presently committed to the exchange of information under the CRS (current as of 24 May 2016). Most recently, Bahrain, Lebanon, Nauru, Panama and Vanuatu have “signed-up”.

Australia will exchange CRS information with all of these participating jurisdictions.

Australia has decided to treat all jurisdictions as Reportable Jurisdictions for Australian CRS purposes. This means that even if an account holder that is tax resident in a non-participating jurisdiction, an RFI will nonetheless be required to collect CRS information and report that information to the ATO. In this case, the ATO will not exchange that information with the non-participating jurisdiction.

This is referred to as the CRS “wider approach”. It contemplates that an increasing number of countries will sign-up to CRS and become participating jurisdictions in the future. Accordingly, this measure (so the story goes!) should reduce compliance costs because all non-Australian jurisdictions are reportable rather than requiring a reporting filter between participating and non-participating jurisdictions.

5.5 Due diligence

The rules for determining whether an RFI has a Reportable Account are set out in the CRS (Sections II to VII). In broad terms an RFI is required to conduct electronic and paper record searches, and collect “self-certifications” from its customers.

A “self-certification” involves an Account Holder attesting to their jurisdiction of tax residency. However, an RFI cannot simply accept this as conclusive in certain circumstances. That is, an RFI cannot rely on self-certification if either:

- the RFI knows or has reason to know that the self-certification is incorrect or unreliable; or
- an account relationship manager has knowledge that the Account Holder is a Reportable Person

The type of due diligence to be undertaken by the Financial Institution depends on whether the account is new or pre-existing, and if pre-existing, whether the account is a “high value” or “low value” account.

For Australian purposes, a new account will be one opened on or after 1 July 2017. The precise due diligence requirements will also depend on the type of account holder - including whether the account holder is a settlor or beneficiary of a trust (beyond this paper’s scope).

Below is a high level summary of some of the due diligence aspects for individuals. Considering due diligence in the context of other entities is beyond the scope of this paper.

5.5.1 New accounts

An RFI is generally required to obtain “self-certification” when a new account is opened. There is no value threshold for CRS purposes. Section IV of the CRS suggests that this:

> may be part of the account opening documentation, that allows the [RFI] to determine the Account Holder’s residence(s) for tax purposes and confirm the reasonableness of such self-certification based on the information obtained … in connection with the opening of the account …

Ideally, “self-certification” should be obtained at the time the account is opened – otherwise it must be completed “as quickly as feasible, and in any case within a period of 90 days”.[100] Penalties can apply where an RFI fails to request self-certification (one penalty unit per instance).

Where an Account Holder is identified as a non-Australian tax resident, then their account is classified as a Reportable Account and the RFI must request that person’s date of birth and taxpayer identifier number (TIN).

If an RFI does not obtain “self-certification” and, if required, the account applicant’s date of birth and TIN, then that RFI should not open the account.

Even if an RFI receives a self-certification indicating that the account applicant is not a foreign tax resident, the RFI must conduct “reasonableness testing” – which would include a review of the other information collected from the account applicant, including to comply with anti-money laundering / “Know-your-client” (AML/KYC) requirements.

5.5.2 Pre-existing accounts

Holders of pre-existing accounts do not need to follow the same self-certification procedures, as set out above for new accounts. Instead, the due diligence requirements for new accounts depend on

[100] ATO, note 99 at 49 of 63.

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whether an account opened before 1 July 2017 is high or low value. An account will be classified as low value where that account balance does not exceed either USD or AUD 1 million on 30 June 2017. In this regard, an RFI can choose which currency to apply under s.396-120(8). Evidently, choosing USD would most likely create a higher materiality threshold which might save on compliance costs.

In some cases,

- For low value accounts, an RFI can look to the recorded residential address as evidence of the Account Holder's tax residence. Nevertheless, in many cases, an RFI will still need to substantiate the recorded address with some other documentary evidence.[101] RFIs have until 31 July 2019 to review their Lower Value Accounts held by individuals.

- For high value accounts, an RFI must review electronically searchable data maintained by the RFI for any indicia of non-Australian tax residency. In some cases, the RFI will be required to undertake paper record searches – including a review of the Account Holder's "current customer master file".

Where an RFI discovers any indicia of tax-residency outside of Australia, or if there is a change in circumstances that results in one or more indicia being associated with the account, then the RFI must treat the Account Holder as reportable, unless certain conditions are met – practically, this will typically involve the RFI obtaining a self-certification to confirm tax residency.

Relevant indicia include the Account Holder's telephone number, and whether there are any standing instructions to transfer funds to a foreign account or a power of attorney granted by a person with an address outside of Australia.

For completeness, and in very broad terms, an RFI must look through certain Passive Non-Financial Entities (NFE) to identify Controlling Persons. If any of the Controlling Persons are Reportable Persons (i.e. non-Australian tax residents), then an account held by the Passive NFE is treated as a Reportable Account.

5.6 What will be reported?

An RFI will need to report the following information with respect to a Reportable Account:

- for an individual: name, address, jurisdiction of tax residence, Taxpayer Identification Number (TIN) and date of birth

- for an entity: the above (ex DOB) plus equivalent details for any Controlling Person (if applicable)

- account number (or function equivalent) and the RFI's identifying number

- account balance or value

[101] For more on this, refer ATO, note 99 at 55 of 63.

- the total gross amount of income generated from that account for the relevant income year – for example, interest on a depository account or interest, dividends and other income on a custodial account.

5.7 Timing of implementation

As noted above, CRS applies to RFIs in Australian from 1 July 2017. RFIs will initially report information for the period from 1 July 2017 to 31 December 2017, and annually thereafter.

The first exchange of information between the ATO and other tax authorities is expected to occur in 2018.

5.8 Some practical CRS implementation issues/dilemmas

Australian based Financial Institutions are currently grappling with the most appropriate way to implement the CRS. In practice, it is not just an extension of FATCA. Instead, Financial Institutions are designing new systems (including IT platforms, training and risk management systems) to become CRS compliant.

Some of the issues that Financial Institutions are grappling with include:

- The tension between CRS compliance and:
  - "the customer experience" - not annoying customers with repeated information requests
  - frontline staff incentives – requesting confidential customer information may dissuade the take up of products (often linked to staff remuneration).
- How to deal with customers with financial products not within the CRS ambit (e.g. a home loan) where the customer subsequently acquires an in-scope product: Should an RFI undertake CRS due diligence for all of its customers indiscriminately?
- Is it better to report Account Holders that are not actually foreign tax residents (over-report) or miss identifying foreign tax residents (under-report)?
- How to deal with CRS compliance in "early adopter" jurisdictions (typically, from 1 January 2016, for example, UK and Ireland, Luxembourg and South Africa) and at the same time roll-out a comprehensive CRS compliance solution for Australia.
- What to do about the backpacker that comes to Australia, falls in love, stays here, and eventually ceases being a tax resident in their home jurisdiction? How frequently should the RFI check that Account Holder's status?

6 (Other) global tax transparency trends

6.1 Introduction

This paper has so far covered some of the key global tax transparency trends – but wait, there's more!

The OECD is the driving force behind most of these initiatives. As a further example of this, on 13 May 2016 the OECD released a report entitled "Building better tax control frameworks".[102] That report provides recommendations on how Revenue Authorities can review the tax risk management and tax corporate governance systems of corporate taxpayers. The report observes that tax transparency is a key driver for these guidelines.

Some of the other key drivers, and other global tax transparency initiatives are discussed below.

6.2 Leaks

The trend to greater tax transparency is evidently not an Australian invention. The global push has received its impetus from many sources, including a succession of "leaks" from Government that have revealed tax avoidance practices. Some examples are briefly discussed below.

6.2.1 SwissLeaks

Involved the public disclosure of more than 100,000 HSBC client accounts. Some of the client files accompanying these accounts suggested that HSBC had actively assisted clients with avoiding disclosure of their assets with clients' home jurisdiction tax authorities.[103]

6.2.2 LuxLeaks

Involved revelations that Luxembourg had issued tax rulings that allowed some MNEs to avoid paying tax elsewhere in the EU.[104] Disclosed documents revealed hundreds of "sweetheart" tax rulings issued by Luxembourg - including to many household name MNEs, such as PepsiCo and Walt Disney.[105]

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[102] OECD (2016), *Co-operative Tax Compliance: Building Better Tax Control Frameworks*, OECD Publishing, Paris*. http://dx.doi.org/10.1787/9789264253384-en*

[103] Whittaker B, "The Swiss Leaks", *CBS: 60 Minutes transcript* (8 February 2015) http://www.cbsnews.com/news/hsbc-swiss-leaks-investigation-60-minutes/.

[104] Hoke W, "EU TAXE Committee to Review LuxLeaks Documents" *Tax Notes International* (15 February 2016).

[105] "Disclosure of LuxLeaks a 'game changer' for EU regulators" *The Irish Times* (22 December 2014).

6.2.3 Ashley Madison

Involved absolutely nothing to do with tax – although it does illustrate how easily ostensible confidential information can be forcibly taken ("hacked") from a website. This involved the leaking of the names of subscribers to a dating website specifically targeted at men and women desiring an extramarital affair – but in actual fact full of male subscribers … so the author is told!

6.2.4 Panama Papers

Involved the public disclosure of 11.5 million legal documents associated with Panamanian law firm, Mossack Fonseca, regarding some 214,000 offshore companies. The papers were anonymously leaked to a German newspapers – that then enlisted the assistance of the International Consortium of Investigative Journalists. Their findings so far indicate that a number of the corporations were used for illegal purposes, including tax evasion and fraud.

For so long as there are revelations of prominent/wealthy individuals and corporations investing through jurisdictions that they have "no business" being in, there will remain serious doubts that those taxpayers are paying their "fair share". Governments respond to this doubt through the measures discussed throughout this paper.

6.3 Exchange of tax ruling information in Europe

6.3.1 Overview

The European Commission presented a package of tax transparency measures on 18 March 2015. A centrepiece of the package is a proposal for the automatic exchange of information between member states regarding their cross border tax rulings. On 6 October 2015, the Council of European Finance Ministers (**ECOFIN**) reached a political agreement on this proposal. Further action must be taken by the European Parliament before the European Commission can formally adopt this proposal.[106]

6.3.2 Purpose

The proposal addresses the following problem:

> Currently, Member States share very little information with one another about their tax rulings. It is at the discretion of the Member State to decide whether a tax ruling might be relevant to another EU country. As a result, Member States are often unaware of cross-border tax rulings issued elsewhere in the EU which may impact their own tax

[106] Loyens & Loeff, "Tax Flash: ECOFIN Council reaches agreement on the automatic exchange of information on tax rulings and APAs" http://www.loyensloeff.com/en-us/news/publications/flashes/tax-flash-ecofin-council-reaches-agreement-on-the-automatic-exchange-of-information-on-tax-rulings-and-apas?utm_source=Mondaq&utm_medium=syndication&utm_campaign=View-Original.

> bases. The lack of transparency on tax rulings is being exploited by certain companies in order to artificially reduce their tax contribution.[107]

That is, tax rulings can be used to grant special benefits "below the radar" and thus deserve serious public and political scrutiny.[108]

6.3.3 Proposed measure

The proposed measure requires EU Member States to "exchange" certain basic information about advance cross-border tax rulings (**tax rulings**) and advance pricing arrangements (**APA**) between EU Member States. That information includes:

- a description of the transactions covered and transaction amounts
- the method and set of criteria used for the determination of the transfer pricing or the transfer price itself
- the identity of other Member States that are likely to be concerned and taxpayers in those states likely to be affected by the tax ruling or APA.

Exchange here is perhaps a misnomer – the basic information is provided to all other Member States, rather than just those Member States mentioned in the particular ruling or APA. In this regard:

> This is based on the principle that it is other Member States which are best placed to assess the potential impact and relevance of such rulings, rather than the Member State giving the ruling. [109]

In appropriate cases the Member States receiving the information can request further more detailed information. Hence this proposal involves both the "push" and "pull" of information.[110]

The exchange of information is to occur automatically every three months via a secure email from 1 January 2017 – but with retrospectivity for certain rulings issued from 1 January 2012.[111]

Some Member States have already pre-empted this measure by entering into bilateral tax ruling exchange arrangements.[112] It is possible that other countries will follow suit, rather than waiting until 1 January 2017 to commence mandatorily exchange.

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[107] European Commission, "Combatting corporate tax avoidance: Committee presents Tax Transparency Package" (Brussels, 18 March 2016) http://europa.eu/rapid/press-release_IP-15-4610_en.htm.

[108] For example, the European Commission considered a Luxembourg ruling issued to Fiat and a Dutch tax ruling issued to Starbucks to be illegal on the basis they each constituted selective tax advantages. See generally, Stappen D, Oepen W and Molla E, "Mandatory Automatic Exchange of Information on Tax Rulings: Political Agreement Reached in ECOFIN Council" *International Transfer Pricing Journal* (January/February 2016) at 9.

[109] European Commission, Proposal for a Council Directive (Brussels (18 March 2015) at 2.

[110] Von Brocke K, "European Union transparency update" in EY, note 85 at 15.

[111] Von Brocke K in EY, note 85 at 16.

[112] For example, on 14 July 2015, The Netherlands and German signed a Memorandum of Understanding regarding the spontaneous exchange of cross border rulings that potentially affect the other country. This applies to rulings granted from 1 January 2015.

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6.3.4 BEPS Action 5

The final report on Action 5: *Countering Harmful Practices More Effectively, Taking into Account Transparency and Substance* was issued on 5 October 2015 – i.e. the day before the ECOFIN's announcement.

The proposed measure supported by ECOFIN is consistent with the BEPS Action 5. In this regard, Action 5 calls for the compulsory spontaneous[113] exchange on ruling related to:

- preferential regimes – such as so called patent boxes
- cross border unilateral transfer pricing rulings, including APAs
- rulings giving a downward adjustment to profits
- permanent establishment rulings
- conduit rulings
- other matters that, in the absence of exchange, could give rise to BEPS issues.

6.4 Mandatory disclosure of aggressive tax arrangements

6.4.1 Overview

In order to address the need for tax authorities to have timely, comprehensive and relevant information regarding aggressive tax planning strategies, the OECD has provided a mandatory disclosure framework in BEPS Action 12. The OECD recommends that the Mandatory Disclosure Rules should contain the following key design features:

- impose a disclosure obligation on both the tax adviser and the taxpayer, or impose the primary obligation on either party
- specify the information to be disclosed, balancing the need to obtain clear and useful information with avoiding undue compliance burdens
- identification of the relevant hallmarks that would trigger a requirement for disclosure
- establish reporting time frames that will provide tax authorities with early access to the information
- introduce penalties to ensure compliance with the regime.

Australia has not yet implemented Action 12. However, the Government announced in the 2016 Budget its intention to introduce certain mandatory disclosure rules. To that end, Treasury released a Consultation Paper on 3 May 2016 to seek community input on the OECD's proposals.

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[113] In this context, "spontaneous" means without the prior receipt of a formal request.

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Submissions are due by 15 July 2016.

6.4.2 Purpose

The final report on BEPS Action 12: *Mandatory Disclosure Rules* was issued on 5 October 2015.

The Mandatory Disclosure Rules address the challenges faced by tax authorities as a result of a lack of timely, comprehensive and relevant information on potentially aggressive or abusive tax planning strategies. The OECD's framework will allow tax authorities to obtain at an early stage the necessary information to identify areas of tax policy, and revenue risk and address them accordingly.

Ultimately, the Mandatory Disclosure Rules' main objective is to provide early information on avoidance schemes and their users. This is intended to deter the use of those schemes by allowing tax authorities to quickly act against a scheme. This reduces the time available for a taxpayer to take advantage of any tax benefit.

6.4.3 Key design features

The OECD has outlined in BEPS Action 12 a framework for the Mandatory Disclosure Rules - modelled around the following key design features:

- **Who reports**

  Countries adopting the Mandatory Disclosure Rules will need to decide whether to introduce dual reporting requirements that apply to tax adviser and taxpayer alike - or only to impose the primary obligation on one of those parties.

  Where the tax adviser is primarily responsible for the reporting obligations, under certain circumstances, it might be necessary for the responsibility to revert to the taxpayer – for example, where:

  - the promoter is offshore
  - there is no promoter
  - the promoter asserts legal professional privilege.

- **What is reported**

  The information to be reported should consist of both the general substance of a scheme as well as specific information relating to that scheme - i.e. taxpayer name, tax file number, details of the transaction etc.

  The application of the regime may incorporate a single or multi-step approach. The latter approach would be based on threshold requirements relating to the features of a scheme. However, no specific thresholds or de minimis filters are recommended by the OECD.

- **Hallmarks**

The best practices set out by the OECD are based on the use of "hallmarks". These will act as tools to identify the features of schemes that should garner the attention of taxation authorities. Both generic and specific hallmarks can be used to capture innovative tax planning strategies as well as targeting known vulnerabilities in the tax system.

- **Consequences of compliance and non-compliance**

  The OECD has recommended that the existing approach to penalties adopted in domestic regimes should continue to apply to a Mandatory Disclosure Regime. To ensure compliance with the regime, the OECD has outlined a framework for financial penalties that should apply if there is a failure to comply with any of the obligations introduced.

6.4.4 Australia's position

The Australian Government has not yet implemented legislation giving effect to the Mandatory Disclosure Rules. As noted above, Treasury issued a Consultation Paper to seek community input. The consultation process is intended to assist Treasury to determine how the Mandatory Disclosure Rules should be devised in the Australian context - including, having regard to the existing disclosure mechanisms available to the ATO.

With reference to the OECD key design features outlined above, Treasury's preliminary positions outlined in the Consultation Paper are as follows:[114]

- **Who reports**

  The Australian Mandatory Disclosure Rules should apply primarily to tax advisers – but in some cases, the reporting obligation should fall back onto the taxpayer.

- **What is reported**

  To minimise unnecessary compliance costs, the information to be disclosed should be clearly specified by the ATO. As such, it is envisaged that a standard ATO form would outline all of the necessary information to be disclosed.

- **Hallmarks**

  A broad discretion should be granted to the ATO to determine which aggressive tax arrangements could trigger the Mandatory Disclosure Rules - with reference to particular features specified by legislation. The ATO would identify arrangements in a manner similar to its current process for identifying aggressive tax arrangements (for example, those addressed in Taxpayer Alerts).

- **When information is reported**

  The ATO will have a discretion to determine when information should be disclosed. However, it should not be earlier than 90 days from the date the ATO announces that a scheme is reportable. A mechanism for a tax adviser to seek an extension of the timeframe will be available.

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[114] The Treasury Department, "OECD Proposals for Mandatory Disclosure of Tax Information: Discussion Paper" (May 2016).

- **Consequences of non-compliance**

  Lateness or non-compliance will give rise to monetary tax penalties. The existing penalty provisions may be applied in such circumstances (subject to industry consultation).

6.4.5 United Kingdom's position

The United Kingdom is a leader in corporate tax transparency.

The UK's *Disclosure of Tax Avoidance Schemes* (**DOTAS**) program is an example of this. DOTAS provides the HMRC with early information about potential tax avoidance schemes based on generic and specific hallmark conditions. Significantly, DOTAS applies to both scheme promoters and taxpayers entering into such avoidance schemes.[115]

In addition, a "special measures" regime was introduced as part of *the Finance Bill 2016* on 24 March 2016. Where businesses engage in aggressive tax planning or refuse to engage with HMRC in an open and collaborative manner, the special measures regime may apply sanctions to the taxpayer.[116]

Currently, there are various proposals yet to be implemented in the UK in relation to tax transparency – in particular:[117]

- A requirement to publish tax strategy and attitude to tax risk on an annual basis. This includes the business' attitude to tax risk, its appetite for tax planning and its approach to its relationship with HMRC.
- Voluntary Code of Practice on Taxation. This will set out best practice tax transparency behaviours expected by HMRC from large businesses.

[115] HM Revenue and Customs, "Guidance: Disclosure of tax avoidance schemes (DOTAS)" (2 September 2015).
[116] Finance (No. 2) Bill 2016 cl 149.
[117] EY, note 85 at 69.

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7 Concluding remarks

The global tax transparency agenda now appears unstoppable. Australia has embraced this agenda. Fuelled by Australia's BEPS leadership aspirations, poorly informed Senators and the Panama Papers and other revelations, this agenda will continue to be pushed. Existing norms of taxpayer confidentiality and commercial-in-confidence will continue to be overtaken by the public's demand for confidence that companies are paying their "fair share".

As more sensitive tax data regarding "household name" companies is made public it will become increasingly important for those companies to explain themselves to their consumers, to the media and to the public at large.

Questions like:

- *Why do you have such a complicated corporate structure?*
- *What business do you have being in <u>that</u> country?*
- *Why should I buy your products ("Like" your brands) when you don't pay much tax in my country?*

will be asked and will need to be convincingly answered.

The tax affairs of multinationals are necessarily complex and nuanced – the challenge will be explaining those complexities and nuances in a way that the public will understand and believe.

This is not the end of the story…

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