Regulation impact statement — Combating multinational tax avoidance

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Background

Global action to address base erosion and profit shifting

Globalisation has exacerbated opportunities for corporate tax avoidance. Internationally, this is known as base erosion and profit shifting (BEPS). Profit shifting is the practice of moving profit from a higher tax country in which economic activity is happening to a lower tax country in order to minimise tax. Profit shifting can lead to governments collecting less revenue — also known as tax base erosion.

The global reach of multinational enterprises, the increasing importance to production of intangible capital (such as intellectual property, goodwill or 'brand names'), rapid developments in information and communication technology and the integration of production in global value chains have increased opportunities for BEPS.

In response, the G20 mandated the Secretary-General of the Organisation for Economic Co-operation and Development (OECD) to develop an action plan aimed at addressing BEPS. The G20/OECD action plan aims to address the weaknesses in the current international tax rules that allow some companies paying little or no tax. The action plan includes 15 action items in three policy areas.

- **Coherence**: International coherence is necessary to eradicate double non-taxation. For example, actions in this area include work to address international mismatches in entity and instrument characterisation.
- **Substance**: Tax rules must be modified to align tax with economic substance. For example, actions in this area include work looking at how transfer pricing rules could better deal with the shifting of risks and intangibles.
- **Transparency**: Greater transparency can reduce the incentive to engage in aggressive tax planning and assist tax authorities to identify risk areas and focus audit strategies.

Australia, as both a G20 and OECD member country, is working with other countries to finalise this work by the end of 2015.

At the St Petersburg G20 Leaders meeting, member countries were also directed to examine how domestic laws contributed to BEPS and ensure that international and domestic tax rules do allow or encourage profit shifting.

Consistent with this direction, this regulation impact statement examines how the Australian tax system could be amended to reduce the opportunities and incentives for multinational tax avoidance. Importantly, the options examined in this regulation impact statement are consistent with the G20/OECD action plan so as not to pre-empt, duplicate or undermine that process.

An early assessment regulation impact statement for these options was considered by the Government as part of the 2015 Budget process. This standard-form regulation impact statement has been prepared for the Government's consideration of the detail of the final legislation.

Problem

Effects of multinational tax avoidance

Tax minimisation, tax avoidance and tax evasion can be considered along a spectrum of activity. At the most egregious end, tax evasion refers to taxpayers deliberately and dishonestly breaking the law to avoid paying tax.

Next to tax evasion is a large grey area, in which taxpayers construct contrived schemes or exploit loopholes to reduce their tax liability. This is known as tax avoidance. Some tax avoidance activity might technically comply with the law but be contrary to its spirit and purpose. Other tax avoidance activity may in fact cross the line of what is legal but will require detailed investigation (and possibly litigation) to determine this.

Tax avoidance can be particularly harmful because it is far more difficult for tax administrations to take action against (compared to tax evasion). This is because, by definition, such behaviour occupies a legal grey area. As a result, it is often seen by the public as going unpoliced.

If ordinary taxpayers lose confidence in the system because they see tax avoidance going unaddressed, there is likely to be a reduction in voluntary compliance. Under the Australian tax system, taxpayers are required to self-assess their tax obligations, rather than the Australian Taxation Office (ATO) reviewing every transaction or event that may have tax consequences. Voluntary compliance is the cornerstone of this system and is more readily achieved when taxpayers have confidence that the tax system is fair and is being evenly applied.

Further, if multinationals are artificially reducing their tax bills, governments are also likely to collect less revenue. The OECD has concluded that a significant source of tax base erosion globally is profit shifting.[1] As a result, taxpayers not engaging in profit shifting shoulder a greater share of the tax burden (than they otherwise would) and face a competitive disadvantage.

Extent of multinational tax avoidance

It is difficult to accurately estimate the extent of multinational tax avoidance in Australia.

In its 2013 report, *Addressing Base Erosion and Profit Shifting*, the OECD noted the lack of available data on the extent of multinational tax avoidance and examined some of the methodological difficulties in quantifying how much BEPS actually occurs. As a result, action 11 of the G20/OECD BEPS action plan is developing recommendations regarding indicators of the scale and economic impact of BEPS and ensuring that tools are available to monitor and evaluate the effectiveness and economic impact of the actions taken to address BEPS on an ongoing basis.

Treasury also noted difficulties in assessing the level of erosion of the corporate tax base that is attributable to tax avoidance in its 2013 scoping paper, *Risks to the Sustainability of Australia's Corporate Tax Base*.

1 OECD, *Addressing Base Erosion and Profit Shifting* (2013).

Despite this, the scoping paper found that:

> There are real and identifiable risks facing Australia's corporate tax base and the corporate tax bases of other countries. The increasing use of strategies to exploit gaps and inconsistencies in tax treaties, the increased 'digitisation' of the economy and the challenges for the international community to effectively curb the harmful tax practices of some jurisdictions, have all highlighted shortcomings in the international tax framework.[2]

The scoping paper also observed that Australia is more vulnerable to the effects of corporate tax base erosion than other countries, given our greater reliance on corporate tax.

Despite the lack of data on the extent of multinational tax avoidance, it is likely that such behaviour has increased over time. This is primarily due to the impact of information communication and technology.

Technology has significantly decreased the cost of organising and coordinating complex activities over long distances. As a result, businesses are increasingly able to manage centrally while spreading functions and assets among multiple different countries.

This allows multinationals to allocate their functions, assets and risks across countries in a way that minimises taxation — for example, by allocating highly profitable assets to low tax countries and low value functions to high tax countries. This, in itself, is not tax avoidance; however, such a structure also allows multinationals to contractually allocate their functions, assets and risks in a way that does not fully reflect reality in order to further reduce their tax. For example, a multinational may overvalue the price paid for services by group members in high tax countries to a group member in a low tax country. This is tax avoidance.

Developments in technology have also meant that intangible assets (such as intellectual property) are becoming increasingly important to the value of countries. For example, much of the value of digital companies lies not in their tangible assets (factories, warehouses, machinery and so on) but in their software. Unlike tangible assets, intangible assets like intellectual property are easily moved between countries. Its mobility and the fact that it can be very difficult to value means that intellectual property can be used to funnel profit across the globe, from high tax to low tax countries, exploiting loopholes in the international tax system along the way.

In this way, technology has given rise to more tax avoidance opportunities than existed in the past.

Existing mechanisms to address multinational tax avoidance

Australia has robust and sophisticated laws that deal with tax avoidance by multinational companies. This includes:

- a comprehensive thin capitalisation regime which aims to prevent excessive debt deductions by companies;
- tough transfer pricing legislation to ensure cross-border related party payments are priced appropriately;
- controlled foreign company rules to prevent Australian companies shifting income offshore; and
- a general anti avoidance rule (GAAR) in Part IVA of the *Income Tax Assessment Act 1936* to capture arrangements designed to avoid paying Australian tax.

2 Treasury, *Risks to the Sustainability of Australia's Corporate Tax Base* (July 2013) page 45.

The G20/OECD action plan is also likely to result in the adoption of rules that make profit shifting more difficult. However, neither Australia's existing laws nor the G20/OECD action plan 'cover the field'.

For example, there are weaknesses in the application of Australia's current GAAR to international tax avoidance schemes. Australia's GAAR, introduced in 1981, has not kept pace with multinationals and the globalisation of their activities. Currently, the GAAR only applies to schemes that have the sole and dominant purpose of avoiding Australian tax. However, typically Australia is a relatively small element in global business structures created in order to enjoy a worldwide tax benefit. Therefore the argument can be used that a scheme is for the purpose of avoiding taxes in other countries and not Australia, which means Part IVA is ineffective in scope.

In relation to the OECD work, its effectiveness will largely depend on how widely the OECD's recommendations are adopted. While the G20/OECD action plan will be delivered in 2015, the extent to which it is taken up will remain unclear for some time after that. It is likely that some jurisdictions will not implement all the recommendations.

In these circumstances, there is a risk that confidence in the fairness of the tax system and voluntary compliance will suffer if action is not taken in a timely way. The Senate Economic References Committee's interim report on corporate tax avoidance, *You cannot tax what you cannot see* (18 August 2015) noted that 'there may be value in Australia proactively continuing to identify potential risks to the integrity of the corporate tax system and take assertive actions to address these risks'.[3] The Committee also considers that 'international collaboration should not prevent the Australian Government from taking unilateral action'.[4]

In this context, there is scope for Australia to take action to address identified issues ahead of the G20/OECD, as long as any measures taken are not inconsistent with the work being done by the G20/OECD. The consistency of each of the options with the OECD process is discussed further below.

The options have been designed in close consultation with Australian officials directly involved in the G20/OECD BEPS action plan so as to mitigate the risks of inconsistency.

Objective of government action

The objective of government action is to reduce the scope for multinational tax avoidance in Australia in a way that is consistent with the G20/OECD action plan.

Options that may achieve objective

The objective could be achieved in a number of ways. Options that could be inconsistent with the G20/OECD action plan have not been considered. These options could be adopted in isolation or together as a package.

Option 1: Status quo

Option 2: A multinational anti-avoidance law

Option 3: Country-by-country reporting

Option 4: Increased penalties

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Options 2, 3 and 4 would only apply to multinationals with an annual global revenue of $1 billion or more ('the revenue threshold'). This is because large multinational companies have the greatest opportunities to avoid tax through offshore activities and represent the highest risk to Australia's tax base. This is consistent with the Government's commitment to deregulation and small business, and with the recommended approach of the OECD on country-by-country reporting.

Option 1: Status quo

This option would involve not taking any action at the present time. Further consideration would be given to this issue when the G20/OECD action plan is finalised in late 2015. Specifically, the Government would consult on and consider whether to implement the outcomes of the G20/OECD process.

Option 2: A multinational anti-avoidance law

Under Australia's bilateral tax treaties, Australia can generally tax business profits made by large foreign multinationals that carry on a business through a permanent establishment in Australia.

The permanent establishment definition can differ in each of Australia's bilateral tax treaties. The definition typically includes a fixed place of business through which the business of an enterprise is carried on, but does not include activities which are only preparatory and auxiliary in nature. Generally, a permanent establishment will also be created if the foreign multinational has a dependent agent in Australia that habitually exercises authority to conclude contracts on behalf of the foreign multinational.

Some large foreign multinationals artificially structure their tax affairs in such a way to ensure that they are not treated as trading through a permanent establishment in Australia and as a result avoid paying the appropriate amount of Australian tax.

This proposal would introduce a new law to allow the Commissioner of Taxation to ignore, for the purposes of determining taxable Australian income, artificial or contrived structures used by multinationals to avoid having a taxable presence in Australia.

The new law would have the effect of clarifying that a limited and clearly egregious set of circumstances involving the provision of goods and services to Australians by offshore entities are considered to be tax avoidance.

The new law would address the weakness with the application of the GAAR to international tax avoidance schemes identified in paragraph 25, by:

- catching arrangements that are designed to obtain both Australian and foreign tax benefits; and
- lowering the purpose test from 'sole or dominant purpose' to 'one of the principal purposes', making it easier to apply.

The changes would apply tax benefits derived on or after 1 January 2016 to allow multinationals a transitional period to reorganise their arrangements.

The action 7 of the OECD action plan will make recommendations about strengthening the permanent establishment rules in the OECD Model Tax Convention so it is harder for taxpayers to artificially avoid permanent establishment status. The new law would be consistent with this work because it would operate as a general safeguard. The law would only apply to a multinational where there was a principal purpose of avoiding tax and this was done by avoiding a permanent establishment (as defined from time to time). In this way, the new law will ensure that both current and future rules about permanent establishments work as they were intended to.

Example 1

A foreign company (FCo) acquires business software from third parties which it sells to customers in Australia.

An Australian company (AusCo), which is a subsidiary of FCo, provides sales support services to FCo. AusCo identifies new customers in Australia, and undertakes all selling activities to the point of concluding the contract with the customer. However, the contract is concluded with FCo and the purchase price paid to FCo directly.

Except for acquiring the software, concluding sales contracts and sending the software to Australian consumers, no activity is performed by FCo in relation to the Australia market.

FCo is resident in a low tax jurisdiction, and its country of residence has a tax treaty with Australia.

From an examination of the facts and circumstances around the arrangements in relation to customer contracts, it is found that there is a contrived separation of the conclusion of contracts from the selling activity and process of agreeing terms and conditions. The requirement for FCo to conclude the contracts is deliberately intended to limit the activity which is taxable in Australia.

The effect of this option would be to allow the Commissioner of Taxation to calculate FCo's taxable Australian income as if it were selling software through a permanent establishment in Australia.

Option 3: Country-by-country reporting

This option would involve implementing the OECD's country by-country reporting regime. country-by-country reporting is a key part of the G20/OECD BEPS action plan and was one of the action item delivered in 2014.

Country-by-country reporting will provide tax authorities with a global picture of how multinationals operate, including information on the global allocation of profits, revenues, taxes paid and other economic activity. The information reported by multinationals in the country-by-country report will allow greater scrutiny of cross-border arrangements by tax authorities.

Under this option, Australian headquartered multinational companies (those who have Australian ultimate holding companies) with a global turnover of greater than $1 billion would provide the ATO with Country-by-Country reports annually, with the first relating to income years commencing on or after 1 January 2016.

The Country-by-country report requires aggregate tax information relating to the global allocation of the income, the taxes paid, and certain indicators of the location of economic activity among tax jurisdictions in which the multinational group operates. The report also requires a listing of all the constituent entities for which financial information is reported, including the tax jurisdiction of incorporation, where different from the tax jurisdiction of residence, as well as the nature of the main business activities carried out by that constituent entity.

The ATO will obtain the country-by-country reports of foreign multinationals operating in Australia under exchange of information arrangements with other tax authorities. In the event that the ATO is unable to obtain this information from other tax authorities, it will be able to require country-by-country reports directly from the Australian subsidiaries of foreign multinationals.

The OECD has also devised two other types of transfer pricing documentation standards to complement the country-by-country report — the local file and the master file. The master file contains an overview of the operations of the entire corporate group (in order to place the multinational group's transfer pricing practices in their global economic, legal, financial and tax context). The local file contains information related specifically to the transactions of the local entity.

Option 3 would involve implementing these standards in addition to the Country-by-Country reports. All multinationals operating in Australia that meet the revenue threshold would be required to file these reports with the ATO.

The affected taxpayers currently prepare some, but not all, of the documentation described above under existing rules. Since 1998, the ATO has recommended Australian taxpayers maintain transfer pricing documentation to ensure they can benefit from the 'reasonably arguable position' defence in relation to their transfer pricing positions. This has meant that many multinationals, particularly those headquartered in Australia, already produce some of the proposed local file content, although this information is not reported to the ATO as a matter of course.

Option 4: Increased penalties

This option would involve increasing the administrative penalties for tax avoidance faced by multinationals. This would achieve a better balance between the financial consequences of tax avoidance and the potential gains for large companies — increasing the deterrent effect of penalties for these firms.

The focus would be administrative penalties for tax avoidance and related behaviour, specifically the penalties in Schedule 1 of the Tax Administration Act 1953 relating to tax avoidance and profit shifting schemes.

Doubling the penalties faced by multinationals would result in a maximum penalty of 120 per cent for tax (where the taxpayer has hindered the ATO or in some repeat cases). This option would not change the underlying tax obligations, only the level of the penalty that may be applied.

In recognition that the tax law does not always provide certain tax outcomes, this option would not further penalise taxpayers who have a reasonably arguable position under the tax law, as defined under Schedule 1 of the *Taxation Administration Act 1953* (the Tax Administration Act).

The Commissioner of Taxation has broad discretion to remit an administrative penalty in whole or in part so the penalties are not often imposed at the rate provided for in the Tax Administration Act. This discretion would remain.

The new penalties would apply to tax benefits obtained on or after 1 July 2015.

None of the 15 G20/OECD BEPS actions will specifically address penalties for tax avoidance so there is no risk of inconsistency. That is, increasing penalties is complementary to the G20/OECD BEPS action plan.

Impact analysis

Option 1: Status quo

The option would have no impact on business, government or the community, with the existing tax framework continuing unchanged.

The existing settings in each area — penalties, anti-avoidance and transfer pricing documentation — as described above would continue.

Option 2: A multinational anti-avoidance law

This option would ensure that the anti-avoidance provisions are able to be applied in the specified circumstances — where multinational groups have used artificial or contrived arrangements to circumvent the international tax rules to avoid a taxable presence in Australia. This will make Australia's tax system less vulnerable to multinational tax avoidance, increasing confidence in the integrity of the system.

For multinationals who engage in the behaviour described, this option would potentially increase their tax liability and may have a negative impact on their reputation if the determination is made public (for example, if it is contested in a court). This result is appropriate given the tax avoidance purpose of their actions.

Example 2

The facts are the same as example 1, with FCO selling software to customers in Australia, heavily supported by AusCo.

Before the application of the law, AusCo was only paid by FCO a service fee, based on AusCo's costs.

Under the new law, if they are taxed like an Australian permanent establishment, they would be expected to share in the profits of the business. This means that their profit will increase as sales increase.

There may also be withholding taxes payable on interest or royalty expenses associated with the Australian sales.

The revenue that these large multinationals are earning in Australia is expected to be in the billions of dollars. However, it is extremely difficult to quantify the amount of profit that would become taxable in Australia (either as a result of ATO enforcement or behaviour change) and the subsequent tax revenue that would be raised.

As such, the gain to revenue associated with this option is unquantifiable.

There is likely to be an upfront regulatory cost associated with learning about the changes and assessing the risk of existing structures. Taxpayers with structures at risk of falling within the scope of the new law may seek advice on its potential application and, if at risk of being caught, may reassess the tax consequences of their existing structure or restructure their operations to remove the artificiality. The ongoing impact on multinational's evaluation and planning is likely to be low.

The potential compliance burden outlined above would be limited to companies that:

- meet the global revenue threshold;
- are supplying goods or services to Australian customers but booking that revenue offshore; and
- have a principal purpose of avoiding tax.

This proposal should not have a direct impact on Australian-owned multinational companies or purely domestic Australian entities because they already have a taxable presence in Australia. These entities will continue to be subject to the GAAR.

While the new law will result in upfront compliance costs, the number of expected multinationals is expected to be limited. It is targeted at 30 large multinational companies, though up to 100 companies may need to review their arrangements to make sure they comply with the new law.

This option is expected to deliver revenue gains, as well as system wide benefits derived from improved taxpayer confidence. While these benefits are unquantifiable, they are expected to exceed the compliance costs associated with the option. As a result, the net impact is expected to be positive.

Option 3: Country-by-country reporting

This option would provide the ATO with a global picture of how multinationals operate, allowing the ATO to better assess transfer pricing risks and allocate audit resources more efficiently.

Australian multinationals already report to the ATO certain elements of the information required in Country-by-Country, master file and local reports. However, this information only relates to the Australian operations of the multinational, and so the ATO's line of sight is restricted to one-side of any given transaction or arrangement. The proposed reporting will provide a clear overview of key financial and operational metrics relevant to the global group. A greater understanding of the economically significant elements of a multinational's entire global value chain will assist the ATO's transfer pricing examinations and the identification of profit shifting activities.

More effective administrative scrutiny may prompt multinational companies to take less aggressive tax positions.

This option would result in an unquantifiable gain to revenue as a result of behavioural change and more effective enforcement.

Australia's support for the OECD's Country-by-Country reporting initiative will encourage other countries to adopt the new reporting requirements maximising the benefits of a more transparent international tax system. The benefits of this option will be reduced if key countries do not participant as foreign multinational's country-by-country reports will be difficult to obtain. However, the ATO will still have the benefit of the master file and local file which are required to be lodged directly with it by all large multinationals operating in Australia.

To date, Spain, the United Kingdom, Germany and Poland have formally announced their intention to legislate the country-by-country reporting regime. Many other jurisdictions have indicated that they are likely to be able to implement it through administrative procedures and so have not made formal announcements.

This option would have a regulatory impact on business. Compiling and reporting the information required will require upfront system changes and ongoing resources. However, this would be limited to a small number of multinational groups. For example, the revenue threshold of $1 billion will exclude 85 to 90 percent of multinationals operating in Australia from the requirement to file a country-by-country, local file and master file reports.

This option is expected to deliver revenue gains, as a result of behaviour changes (multinationals taking less aggressive tax positions) and more effect enforcement, as well as system wide benefits derived from improved taxpayer confidence. While these benefits are unquantifiable, they are expected to exceed the compliance costs associated with the option. As a result, the net impact is expected to be positive.

Option 4: Increasing penalties

Substantially increasing the penalties for large companies will ensure a better balance between the financial consequences of tax avoidance and the potential gains for multinational companies.

Tax avoidance by these entities is arguably more serious than that engaged in by smaller entities because multinational companies have:

- more resources to devote to tax compliance activities;
- greater opportunities to avoid tax through offshore activities; and
- larger potential gains to be made by avoiding tax.

Given the consequences of non-compliance would be higher under this option, some multinationals may take conservative tax positions. For example, currently if a multinational misprices its intergroup payments in order to reduce the tax it pays in Australia, it would only face a penalty of 25 per cent of the tax avoided. Under this option, the penalty would be raised to 50 per cent — making this type of tax avoidance more risky for multinationals.

This option would result in net positive benefits for Government and the community. An increase in the penalties for large companies may also increase community confidence in the tax system, countering the perception that small and medium enterprises shoulder an unfair burden.

This option would have an unquantifiable gain to revenue. This is likely to result from both increased penalties being collected and an increase in primary tax compliance.

It should be noted, however, that the Commissioner does not always impose the maximum penalty (as noted at paragraph 19).

There would be no direct regulatory costs for business as the primary tax obligations would not change. As such, the net impact of the option will be positive.

Regulatory costing analysis

Option 1: Status quo

As this option does not involve changes to the status quo, no regulatory costing is required.

Option 2: a multinational anti-avoidance law

Table 1: Average annual regulatory costs (from business as usual) for Option 2				
Change in costs (\$million)	**Business**	**Community Organisations**	**Individuals**	**Total change in cost**
Total by sector	\$9.2 million	\$0	\$0	\$9.2 million
The increased regulatory costs are offset by the regulatory cost reductions associated with a proposal to align the legal frameworks for personal and corporate insolvency practitioners.				
Cost offset (\$million)	**Business**	**Community Organisations**	**Individuals**	**Total by Source**
Agency	\$29.5 million	\$0	\$0	\$29.5 million
Are all new costs offset? ✓ yes, costs are offset ☐ no, costs are not offset ☐ deregulatory, no offsets required				
Total (Change in costs — Cost offset) (\$million)	- \$20.3 million			

Table 2: Summary — potential compliance costs for Option 2	**Implementation**	**Ongoing**
Potential overall costs per client (\$)	\$920,000	\$0
Potential overall market impact (\$)	\$92,000,000	\$0

Up to 100 multinationals may be affected.

Tables 1 and 2 above summarise the potential compliance costs. It assumes that 30 affected taxpayers will need to restructure their Australian business operations to comply with the new law.

Table 1 summarises the average annual compliance costs over ten years for the total affected population.

Table 2 summarises the yearly compliance costs per multinational and for the total affected population.

All affected multinationals are likely to seek legal advice on whether the new law has an impact on their existing structure.

Multinationals who have a high risk of being caught by the new law are likely to incur both internal and external costs:

- developing and assessing the costs and benefits of alternative options for restructuring;
- documenting the preferred restructure option, its tax consequences and settling this with the ATO; and
- implementing a new business model according to the preferred restructure option.

As the law targets particular structures (rather than transactions) the ongoing costs are likely to be marginal once a compliance structure is in place.

While some taxpayers may come within the scope of the law over time as their revenue increases, most of these are likely to have already restructured as a result of the OECD's recommended changes on permanent establishment, which are to be implemented over the next few years. The law will also deter multinationals from entering into the targeted structures in the first place.

Option 3: Country-by-country reporting

Table 3: Average annual regulatory costs (from business as usual) for Option 3				
Change in costs (<u>$million</u>)	**Business**	**Community organisations**	**Individuals**	**Total change in cost**
Total by sector	$14.05 million	$0	$0	$14.05 million
The increased regulatory costs are offset by the regulatory cost reductions associated with a proposal to align the legal frameworks for personal and corporate insolvency practitioners.				
Cost offset (<u>$million</u>)	**Business**	**Community Organisations**	**Individuals**	**Total by Source**
Agency	$29.15 million	$0	$0	$29.15 million
Are all new costs offset? ✓ yes, costs are offset ☐ no, costs are not offset ☐ deregulatory, no offsets required				
Total (Change in costs — Cost offset) (<u>$million</u>)	**- $15.10 million**			

Table 4: Summary — potential compliance costs for Option 3	**Implementation**	**Ongoing**
Potential overall costs per client ($)	$56,028	$6,103
Potential overall market impact ($)	$67,234,167	$7,323,070

Tables 3 and 4 above summarise the potential compliance costs. They assume that:

- each Australian taxpayer that meets the revenue threshold would be required to lodge a master file and local file 12-months after year end; and
- in most cases only Australian-headquartered taxpayers above the threshold will have to lodge a country-by-country report.

Based on this between 800 and 1,200 multinationals will be affected, including 30 to 50 Australian-headquartered taxpayers. This population is based on the number of companies which lodge an international dealings schedule with total effective business income greater than $1 billion.

As the threshold is not indexed, there may be an increase in the affected population over time. The option has been costed using the upper estimate of the population (1,200) in part to deal with this.

Table 3 summarises the average annual compliance costs over 10 years for the total affected population.

Table 4 summarises the implementation and ongoing annual compliance costs per multinational and for the total affected population.

The assessment assumes that the affected taxpayers are quite sophisticated and that the majority of information required to be completed in the forms will be relatively simple to extract once appropriate systems are in place.

Option 4: Increasing penalties

As this option does not involve changes to underlying tax obligations (only the penalties that may apply), no regulatory costing is required.

Consultation

Treasury released an issues paper in May 2013 which outlined the challenges that changes in the global economy pose to the international tax system and sought stakeholder views on whether the analysis in the paper adequately captured the key issues. The paper did not canvas potential solutions — its focus was defining the nature of the problem.

Prior to the release of the 2015 Budget, each of the options was the subject of targeted consultation with a small selection of representatives from the tax profession, business and academia. These stakeholders were given summaries of the proposals on an in-confidence basis. Treasury met with these stakeholders in groups and had one-on-one conversations, which informed the policy decision.

The limited consultation on the proposals prior to their announcement in the budget reflects the cabinet-in-confidence nature of the decision-making process.

Following the announcement of these measures in the 2015 Budget, Treasury publicly consulted on the measures as set out below.

Multinational anti-avoidance law

An exposure draft Bill and explanatory memorandum on the multinational anti-avoidance law were published for consultation on Budget night. The consultation period ran for four weeks and closed on 9 June.

The purpose of the consultation process was obtain feedback on the design of the law, specifically whether the law would:

- have the intended effect of enabling the ATO to take action against multinationals that artificially avoid having a taxable presence in Australia;
- have any unintended effects, including whether it would catch any legitimate business arrangements; and
- be sufficiently clear.

Treasury received 20 submissions from a range of stakeholders including: not-for-profits, professional firms and industry bodies.

Most submissions raised similar issues. The key themes included:

- a preference for waiting until the OECD/BEPS process is concluded;
- concerns about the start date and suggestions for ways in which the ATO can facilitate the transition; and

- the importance of defining key terms: ‘low or no tax’, ‘commercially dependant’, ‘substantial economic activity’ etc.

Treasury also consulted heavily with the ATO to identify any implementation issues, integrity concerns and unintended consequences.

A number of changes were made as a result of the submissions and ATO feedback. These and the names of those that made non-confidential submission are outlined in the appendix.

Country-by-country reporting

An exposure draft Bill and explanatory memorandum to implement country-by-country reporting was published for consultation on 6 August. The consultation period ran for four weeks and closed on 2 September.

The purpose of the consultation process was to obtain feedback on the design of the law, specifically whether the law would have the intended effect of enabling the ATO to implement the OECD standards with sufficient flexibility.

Treasury received 15 submissions from a range of stakeholders including: not-for-profits, professional firms and industry bodies.

- Most submissions acknowledged that it was appropriate to give the ATO power to detail the content of the reports so that they could be kept up to date with any revised OECD guidance.
- Similarly, many supported the ATO’s broad powers to exempt entities from the requirement to lodge one or more of the reports; however, some expressed a preference for some exemptions to be legislated.

A number of changes were made as a result of the consultations. These and the names of those that made non-confidential submission are outlined in the appendix.

The OECD’s country-by-country reporting regime has also been subject to broader consultations conducted by the OECD. The OECD has been consulting publicly on revisions to its transfer pricing documentation since 2013. A number of Australian stakeholders participated in these consultations directly (including CPA Australia, Institute of Chartered Accountants in Australia, Antony Ting and Rio Tinto) or indirectly through the Business and Industry Advisory Council (BIAC) to the OECD.

Increasing penalties

An exposure draft Bill and explanatory memorandum to implement increased penalties for tax avoidance and transfer pricing schemes was published for consultation on 6 August. The consultation period ran for four weeks and closed on 2 September.

Given the simple nature of the change, the purpose of the consultation was to ensure there were no technical errors in the law.

Treasury received three submissions (from Deloitte, the Tax Justice Network and Publish What You Pay Australia, plus one confidential). There were a few technical issues identified with the operation of the provisions which have been addressed. There were also policy concerns about:

- the application of the increased penalties to schemes entered into before 1 July 2015;
- the increased importance of having a reasonably arguable position and the impact of the existing documentation requirements on this; and

- the fact that the increased penalties will only apply to entities who meet the global revenue threshold of $1 billion or more.

Conclusion

The preferred option is to implement options 2, 3 and 4 as a package. Each of these options is expected to have a net benefit (although the benefits are difficult to quantify for options 2 and 3). As such, implementing options 2, 3 and 4 as a package is expected to result in the highest net benefit.

The options are complementary and address the problem of multinational tax avoidance from different angles. Country-by-Country reporting gives the ATO information to assist it target its compliance activities; increased penalties provides multinationals with a bigger incentive to comply with the law; and the multinational anti-avoidance law ensures the ATO can recover tax and penalties where a multinational has structured to avoid a taxable Australian presence.

Implementation and review

Legislation is required to implement the package. As the start dates for both country-by-country reporting and the multinational anti avoidance law are 1 January 2016, a Bill implementing the package will need to be introduced to the Parliament in the spring sittings and enacted before the end of the year.

The ATO administers the existing general anti-avoidance rule, penalty regime and transfer pricing documentation rules. It is well placed to both implement the changes and monitor their effects on the behaviour of corporate taxpayers.

Multinational anti-avoidance law

The ATO's existing policies and procedures for the administration of the general anti-avoidance rule and penalties will continue to apply, although some modification and additional guidance will be necessary to reflect the changes.

The ATO will publish draft guidance on the new multinational anti-avoidance law before the end of the year and will be consulting with stakeholders on what topics they would like the guidance to cover.

The ATO is well placed to monitor the effectiveness of the multinational anti-avoidance law. Affected multinationals are likely to seek interim relief from the ATO as they seek to restructure their arrangements to comply with the law.

The ATO has indicated that it can adopt a flexible approach to administering the law for companies that are in the process of restructuring but do not have their new arrangements in place on 1 January 2016. For multinationals that voluntarily approach the ATO, penalties can be waived or reduced and specific arrangements can be made regarding compliance. This is under the Commissioner's discretional powers and is dependent on the relevant facts and circumstances of each case.

Country-by-country reporting

For country-by-country reporting, there will be some changes required to the ATO's existing data capture systems to process and utilise the information. The ATO will also need to prepare legislative instruments and guidance material to implement the changes. The ATO has already commenced consultations on the development of these materials. The Government has provided the ATO with $11.3 million over the forward estimates period to undertake these activities.

The information will be managed by the ATO's existing solid governance structures and established procedures to keep it secure. It will also be subject to the existing taxpayer secrecy laws, which apply to all tax information.

The ATO has well established teams with a proven history of delivering complex projects that enable the analysis of detailed financial information. The ATO is also well advanced in the practice of automatic exchange of information and well regarded internationally in this area.

The OECD has stated that it will review the implementation of its new documentation standards in 2020. Treasury and the ATO will examine the operation of country-by-country reporting in Australia in order to provide input into the OECD's review.

Penalties

While minor changes to the ATO's existing policies and procedures on the administrative penalty regime will be required, these are less urgent than for the other measures, given the straight forward nature of the changes.

As part of its response to a review by the Inspector General of Taxation, the ATO has agreed to report and publish the number and value of administrative penalties it imposes. This will allow for ongoing monitoring of how administrative penalties are being applied.

Appendix — changes made as a result of consultations

Multinational anti-avoidance law

	Feedback received	Changes made
	Application start date	
1.	Many submissions proposed that the start date be pushed back, or if the start date remains 1 January 2016, that administrative arrangements should be put in place to allow multinationals to restructure their arrangements.	No changes to the law. The ATO has indicated that it can adopt a flexible approach to administering the law for companies that are in the process of restructuring but do not have their new arrangements in place on 1 January 2016. For multinationals that voluntarily approach the ATO, penalties can be waived and specific arrangements can be made regarding compliance. This is under the Commissioner's discretional powers and is dependent on the relevant facts and circumstances of each case.
	Connection with a low or no tax jurisdiction	
2.	Submissions raised concerns about the lack of clarity around key concepts used in these subsections, particularly: • what is a 'a low rate' of corporate income tax; • whether a 'low rate of corporate income tax' takes account of other taxes, such as mining royalties; • when is an activity 'related, directly or indirectly' to the supply; • what is 'substantial economic activity'; and • the timing and content of the information to be given to the Commissioner under subsection 177DA(11).	Issues identified by stakeholders with this provision are no longer relevant as the provision has been removed. This simplifies the law.
	The purpose tests (paragraphs 177DA(1)(b) and (1)(c))	
3.	Submissions raised concerns about the two-tiered purpose test. Specifically: • the requirement for the taxpayer to undertake the subsection 177D(2) analysis twice: once in making an assessment about the design of the scheme and a second time in making an assessment about a person's or persons' purposes in entering into or carrying out schemes; and	The purposes tests in paragraphs 177DA(1)(b) and (c) were altered to ensure that there is only one test of purpose or intent with the other criteria being objective. This means that avoiding an Australian permanent establishment has been changed from being a purpose of the scheme, to a means used in the scheme for the purpose of obtaining a tax benefit, through the addition of further factors to consider under subsection 177DA(2).

	Feedback received	Changes made
	• the need to satisfy the imprecise requirement of whether a corporate structure is 'designed to avoid' Australian tax.	The examples provided in the EM have been expanded in order to provide better guidance and instruction on whether the purpose test would be satisfied.
	Additional factors to have regard to in determining whether purpose test is satisfied (subsection 177DA(2))	
4.	There was some concern that having regard to the relevant factors in subsection 177D(2) would not be particularly helpful in determining whether or not the purpose test under paragraphs 177DA(1)(b) and (c) would be satisfied.	The final Bill includes additional matters that the Commission was have regard to. The additional matters are specific to the arrangements being targeted.
	Description of the scheme (paragraph 177DA(1)(a))	
5.	Submissions raised concerns about the lack of clarity around key terms/concepts.	***Non-resident and Australian resident:*** The concepts of 'non-resident' and 'Australian resident' have been amended to ensure include partnerships, trusts and resident entities are covered. ***Makes a supply:*** The definition of supply has been modified to carve out the sale of shares, debt interests and other similar interests in order to give private equity funds clarity that they are not caught if they use Australian managers to sell Australian assets. ***Commercially dependant on:*** Several submissions made suggestions for how to clarify this concept. Further guidance has been provided in the explanatory material. ***In connection with the supply:*** This element has been tightened to require a 'direct' connection. The addition of specific factors to which the Commissioner must have regard to will also provide more guidance on the types of mischief being targeted.
	Global revenue threshold	
6.	Some submissions suggested changes to the threshold (for example, it should be based on tax avoided rather than revenue). Others commented on the mechanics of the provision.	A centrally-located definition has been created in the *Income Tax Assessment Act 1997* to refer to entities that are part of a consolidated group with annual global revenue of $1 billion. As part of this process, many of the mechanical issues were addressed.

	Feedback received	Changes made
	'Tax benefit' and Australian and foreign tax liabilities	
7.	Submissions queried why paragraph 177DA(3)(a) (which allows a consideration of any reduction in other Australian tax liabilities as part of the purpose test) was included. Many submissions requested more guidance on what the Australian tax benefit would be and how profits would be attributed to a notional permanent establishment.	***Deferrals:*** The provisions clarify that a reduction of a foreign tax liability includes a deferral of a foreign tax liability. ***Other Australia liabilities:*** Paragraph 177DA(3)(a) has been deleted as the reduction of Australian tax liabilities is covered under the concept of Australian tax benefit. ***Australian tax benefit:*** More guidance has been provided in the explanatory memorandum on what the expected Australian tax benefits might be.

Non-confidential submissions

- American Chamber of Commerce
- Australian Financial Markets Association
- Baker & McKenzie
- Business Council of Australia
- Booth, Alison
- Chartered Accountants Australia and New Zealand
- CPA Australia
- Deloitte
- Ernst & Young and Corporate Tax Association Joint Submission
- Ernst & Young and Corporate Tax Association Joint Submission — Additional Information
- Ernst & Young
- Institute of Public Affairs
- KPMG
- Law Council of Australia
- PwC
- The Tax Institute
- Tax Justice Network Australia
- United Voice.

Two confidential submissions were also received.

Country-by-country reporting

	Feedback received	Changes made
	Content of reports	
1.	A key issue raised by stakeholders was the need for clarity about the content of the reports. The need to minimise overlap with existing reporting requirements was also emphasised.	The ATO is working to provide guidance on the content of the reports.
	Transitional provisions	
2.	Some stakeholders were concerned that the legislation would require the local subsidiaries of foreign multinationals to compile and lodge country-by-country reports ahead of the implementation of country-by-country reporting in the parent company's jurisdiction.	The OECD clearly envisages that automatic exchange between tax authorities will be the primary mechanism for the receipt of foreign multinationals' Country-by-Country reports. The ATO has scope under the legislation to implement practical arrangements in the transition period.
	Exemptions	
3.	Several stakeholders requested that the exemptions envisaged in the explanatory memorandum be moved into the law. For example, the ATO should be required to provide exemptions where the information in the reports can be obtained from another tax authority or taxpayer.	The ATO's power to provide exemptions has been left broad. Additional guidance has been provided in the explanatory memorandum and a power to exempt by regulation has been introduced.
	Timing of reports	
4.	Submissions raised a number of concerns about the income periods to which the reports must relate and the timing of lodgement.	Additional flexibility has been introduced, including to allow the ATO to accept country-by-country and master file reports that relate to the income year of a parent company.

Non-confidential submissions

- Association of Superannuation Funds of Australia
- Australian Bankers' Association
- Chartered Accountants Australia and New Zealand
- Corporate Tax Association
- Mr Francesco Cortellese
- Deloitte
- Federal Chamber of Automotive Industries
- Greenwoods & Herbert Smith Freehills Pty Limited
- KPMG
- Minerals Council of Australia
- Tax Justice Network and Public What You Pay Australia
- The Tax Institute.

Three confidential submissions were also received.