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Submission on Treasury Issues Paper

Implications of the Modern Global Economy for the Taxation of Multinational Enterprises

1. Introduction

1.1 Micah Challenge Australia: Who we are

Micah Challenge is a global movement of Christian agencies, churches, groups and individuals speaking out against poverty and injustice, and advocating to governments for strong action to achieve the global anti-poverty Millennium Development Goals (MDGs). Micah Challenge is a coalition of Christian development NGOs as well as mission agencies, churches and church bodies and individuals. A full list of our Coalition partners can be found in Annex 1.

Together with Make Poverty History, we advocate to the Commonwealth Government in support of policy likely to contribute to the achievement of the MDGs, the sustainable reduction of poverty and a more just world.

1.2 Why we are making this submission

Micah Challenge recognises that the solutions to poverty involve more than aid alone and that policy positions adopted by the Commonwealth Government – other than those specifically related to aid – can have positive or negative effects on sustainable human development and poverty reduction in our region and beyond. Trade, investment and immigration policies and strategies are obvious examples. Australia's stance on tax law, policy and international arrangements around tax also have a clear connection to the capacity of governments in developing countries to secure sufficient and sustainable sources of financing for development. Pressing for reform on the international tax system also has the potential to build and strengthen norms of transparency and accountability among and between governments, citizens and businesses – particularly multinational enterprises (MNEs).

For these reasons, we recognise the significant opportunity that is presented by the OECD's decision to work towards the reform of the global tax system. We see this as a moment of great potential for positive change to a system which no longer reflects the economic realities of our world and which imposes substantial, and often unmanageable, burdens for the tax authorities of developing countries, particularly Low Income and Least Developing Countries, with negative consequences for revenue collection and delivery of services to the poor.

We welcome the opportunity to make a submission in response to the Treasury Issues Paper, *Implications of the Modern Global Economy for the Taxation of Multinational Enterprises*, with the aim of ensuring that the Australian Government will consider the interests of the world's poor in its Scoping Paper, and in the position it takes on these matters in the OECD and G20. While we recognise that the Issues Paper is framed around Australia's domestic revenue concerns in identifying and addressing the practise of profit shifting, and accept that this of course should be a high priority for Government, it should not be the only consideration in the development of the Scoping Paper.

Almost 1,000 Micah Challenge supporters[1] have begun campaigning on tax and transparency, calling for Australia to require country by country reporting for MNEs. This submission builds on that call.

[1] During our September 2012 *Voices for Justice* event, almost 300 Micah Challenge supporters held 100 face to face meetings with MPs and Senators, advocating for legislation requiring country by country reporting for MNEs registered in Australia. An online petition making the same call received 651 signatures.

2. The Problem: The global tax system is failing, and failing the poor particularly

The OECD's *Base Erosion and Profit Shifting* report highlights numerous failings in the current global tax system, several of which are reiterated in the Treasury issues paper. As noted, the "tax practices of some multinational companies have become more aggressive over time, raising serious compliance and fairness issues."[2] However, the tax practices of multinational enterprises are only part of the problem. Many aspects of the modern global economy and financial system serve to facilitate tax avoidance and evasion, and need to be addressed. Analysis by Global Financial Integrity suggests that Sub-Saharan Africa – the continent most in need of additional financing to achieve sustainable poverty reduction and human development – lost USD 854 billion in illicit financial flows between 1970 and 2008, double the Official Development Assistance it received over this period.[3] The report notes that this illicit loss has been a result of, or facilitated by, "tax havens, secrecy jurisdictions, disguised corporations, anonymous trust accounts, false foundations, trade mispricing and money laundering." Only one of these directly relates to the taxation of multinational enterprises, but all are relevant in contributing to a global financial ecosystem that facilitates tax avoidance and evasion, as well as other crimes.

Given the disproportionate impact on the poorest nations and the poorest people, we are concerned that the Treasury discussion paper makes no specific mention of the particular challenges faced by developing countries in general, and by Low Income Countries (LICs) and Least Developed Countries (LDCs) in particular, when it comes to securing their revenue bases against aggressive tax minimisation and evasion. While we accept that Australia's revenue integrity should be a primary concern for the Commonwealth, not to mention these problems and canvas potential solutions that could benefit developing countries is an oversight that we hope will be rectified in the final Scoping Paper.

Australia has the opportunity to take a strong leadership role in reforming the global tax rules, and should be ambitious in the positions it adopts and the efforts it exerts to secure this reform. We call upon the Australian Government to make a strong submission to the OECD call for consultation, and to accelerate action against tax avoidance through its membership and upcoming presidency of the G20.

We recognise that the solutions to the problems of base erosion and profit shifting will be complex and require coordinated response at the national and the international level, as well as over the shorter and longer timeframes.

3. Specific Recommendations

Recommendation 1: Australia should work to ensure that the OECD and G20 processes create space for genuine engagement by the governments and civil societies of those developing countries not part of the G20. Australia should also ensure that the interests of Low Income and Least Developed Countries are considered in its Scoping Paper and in the positions that Australia adopts within the OECD and G20.

Base Erosion and Profit Shifting (BEPS) is a global problem that affects all nations, with poorer developing countries, particularly, lacking the resources to guard against BEPS through domestic tax laws, nor to identify and take effective action against it. As a simple matter of justice, then,

[2] OECD, *Addressing Base Erosion and Profit Shifting*, 2013, p.6
[3] Global Financial Integrity, *Illicit Financial Flows from Africa*, 2009

Australia needs to ensure that the position it adopts within the OECD and the G20 supports the efforts of developing countries, particularly LICs and LDCs, to secure their revenue base by fair taxation of MNEs operating in their jurisdiction.

By ensuring that, through reforms to the international tax rules, developing countries are better able to secure sufficient revenues for sustainable human development and poverty reduction, the Government would be acting in accordance with international commitments expressed in the Millennium Declaration to "spare no effort" to help achieve the Millennium Development Goals and in the Monterrey Consensus on Financing for Development to help mobilize and increase "the effective use of financial resources and achieving the national and international economic conditions needed to fulfil internationally agreed development goals."[4] It would also complement the work of the Mining for Development initiative, as well as the legal and institutional reform and capacity building around public administration and tax currently being undertaken through a number of AusAID country programs. Building the revenue bases of developing countries and reducing dependence among Australia's aid partner countries also has longer-term positive revenue implications for Australia through enhanced opportunities for trade and investment, as well as in a shift from an aid donor and aid recipient relationship to other diplomatic and commercial relationships.

Finally, the OECD is a rule-making body comprised only of developed countries that lacks legitimacy with regard to developing and imposing norms and regulations around international taxation on the entire international community – a point forcefully made by India's Permanent Representative to the UN in his March 2012 letter[5]. For Australia to ignore the interests and concerns of developing countries – including those smaller developing nations represented in neither the OECD nor the G20 – would be, at best, to further entrench the perception that the OECD's tax rules protect only the interests of developed countries, and, at worst, to confirm that this is indeed the case. Either way, support for, and legitimacy of, any multilateral reforms to address Base Erosion and Profit Shifting would be gravely undermined if the interests and concerns of developing countries were not clearly considered in the submissions and positions of OECD members. Recent actions by Mongolia and Zambia to rescind tax treaties indicate that increasingly developing countries are prepared to take matters into their own hands when confronted with a system that clearly does not work in their interests.

As a first step towards ensuring the participation of LICs and LDCs in this discussion, Australia should call on the OECD and G20 to present their draft action plan to the UN Committee of Experts in International Cooperation in Tax Matters for meaningful input.

Recommendation 2: Australia's Scoping Paper should consider the OECD's identified priorities for short-term action, but maintain open pathways to more systemic reform of the international tax system.

We recognise that more systemic reforms of the global tax system will require long-term, coordinated, and multilateral engagement. We believe that the current system of taxing MNEs as if intra-group transactions could be meaningfully assessed by an "arms length principle" has demonstrated its fundamental unworkability. The rules for transfer pricing (TP) assessments are already complex, and often beyond the capacity of developing country tax authorities to

[4] Report of the International Conference on Financing for Development, Monterrey, Mexico, 2002, paragraph 2
[5] http://www.un.org/esa/ffd/tax/2012ICTM/LetterIndia.pdf

adequately legislate TP regimes, conduct TP audits and negotiate adjustments with MNEs who are, generally, vastly better resourced with tax specialists and lawyers.

Further more, it is clear that the current approach to taxing multinationals facilitates a significant amount of tax avoidance, to the detriment of many governments' revenues, but with a particularly serious impact on the poorest countries. Christian Aid, for example, estimates that developing countries lose approximately USD 160 billion each year through transfer mispricing and false invoicing.[6] In India alone, the Directorate of Transfer Pricing deems mispricing to have taken place on an estimated USD 12.6 billion of transactions in 2011-12.[7]

There is, in fact, a strong case for viewing MNEs as highly integrated entities and moving away from the purely transactional approach of arm's-length pricing for taxing them and towards an approach that taxes them according to an agreed formula that accounts for their activities in each jurisdiction and the contribution of those activities to the profitability of the whole enterprise. Professor Kerrie Sadiq, arguing specifically for a formulary apportionment approach to be taken to taxing multinational banking enterprises, notes that,

> When corporate tax differentials are disregarded, internal transactions are meaningless to management, as it is the entity's overall aim to minimize expense and maximize profits as a whole, not of the separate parts at the expense of another part of the entity. Yet, inconsistently with this rationale, arm's-length pricing takes into account these transactions and assumes that each part of the entity is a separate profit center. This is generally not overall management strategy. Consequently, formulary apportionment, which ignores all of the internal transactions, is consistent with the aim of the efficient operations of the multinational entity.[8]

Not only would this shift towards formulary apportionment better reflect the economic realities of contemporary, highly-integrated MNEs, but it would also have positive impacts on competitiveness between MNEs and enterprises operating in a single jurisdiction, as it "levels the playing field for all business competitors by basing taxes on what they actually earn on an overall basis, not on the basis of whether they are domiciled in the United States or another country, or the skill of their tax compliance staff in manipulating the rules."[9]

We accept that alternatives such as formulary apportionment and unitary taxation would be difficult to implement and will involve sequenced, bilateral and multilateral staging. In making its submission, then, Australia should be guided by the principle that any short or medium term action adopted by the OECD should not, via path-dependency, lock-in clearly failing tax measures – and we suggest below that the arms length principle as the dominant guideline for transfer pricing is one such – nor exclude larger potential transformations of the global tax system – for example, moving towards a formulary approach to tax apportionment across jurisdictions with unitary taxation applied to MNEs.

[6] Christian Aid, *Death and Taxes*, May 2008, p.53
[7] Christian Aid, *Who Pays the Price,* 2013, p.
[8] Sadiq, "Taxation of Multinational Banks: Formulary Apportionment to Reflect Economic Realities", *Proceedings of Transfer Pricing, Helsinki*, 2012, p.12
[9] Miller, "None Are So Blind as Those Who Will Not See," 66 Tax Notes 1023 (1995), page 1035

Recommendation 3: Australia should actively promote the development and deployment of country by country reporting for MNEs as a global norm, and should develop domestic legislation to require this of MNEs registered in Australia.

While we do not regard country by country reporting as a single solution to tax avoidance and evasion, it is a critical step that provides transparency and clarity for businesses and investors, as well as opening up channels for accurate information sharing and accountability among MNEs, governments and citizens.

Australia has a unique opportunity with its upcoming presidency of the G20, and should strongly urge all G20 nations to require country by country reporting for MNEs registered in their jurisdictions. MNEs should be required to publish annual worldwide combined reports, including consolidated accounts, to the tax authorities of every country in which they operate. This country by country report should provide a breakdown of employees, assets, sales, profits, taxes due and paid, sales, purchases, labour costs and financing costs for the operations of the MNE. Australia should also begin the consultation and drafting work to prepare domestic legislation requiring this before it assumes the G20 presidency.

Australia is already lagging behind significant international movement on country-by-country reporting. The US Dodd-Frank Wall Street Reform and Consumer Protection Act requires all MNEs in the oil, gas and mining sectors who report to the US Securities and Exchange Commission to report on the taxes and royalties they pay to governments on a country by country and project by project basis. Similarly, the EU has also agreed to amend its Accounting and Transparency Directives to require MNEs in extractive industries to report on payments to governments on a country by country and project by project basis. The European Parliament has also voted to require Country By Country Reporting of European banks through a revision to the Capital Requirement Directive and has indicated an intention to extend this requirement beyond the banking sector.

Recommendation 4: Australia should actively pursue the establishment of Automatic Exchange of Tax Information as the global, multilateral standard.

Tax Justice Network research suggests that tax evasion by individuals over the last few decades has led to something in the order of USD 21 – USD 32 billion dollars of untaxed wealth being held in tax havens, with approximately 25–30% of this coming from developing countries.[10]

We note that automatic exchange of tax information is increasingly becoming the norm, with many countries already benefiting from bilateral arrangements that provide for automatic exchange of information. The US Foreign Account Tax Compliance Act, and proposed changes to the EU Savings Tax Directive both further entrench automatic exchange of information as the standard.

We note, also, that Australia already provides information on tax related matters to over 40 countries and receives information automatically from 20 countries, and so is in practice committed to the automatic exchange of tax information with treaty partners.

However, OECD analysis of the current state of play demonstrates that very few developing nations are currently able to benefit from this automatic information exchange, and no developing

[10] Tax Justice Network, *The Price of Offshore Revisited*, 2012, p.9

countries outside of the G20.[11] Australia should take a strong position within the OECD and G20 that mechanisms need to be established to facilitate access for all developing countries to automatic exchange of tax information. Otherwise, they will continue to have limited or no access to information that would help them identify and clamp down on tax evasion and other forms of illicit capital flight. Existing treaties and mechanisms should be examined for the extent to which they facilitate or hinder such access for all developing countries and revised accordingly.

Recommendation 5: Australia should advocate for full implementation of Financial Action Taskforce (FATF) Recommendations 24 and 25 on transparency and beneficial ownership of legal persons and arrangements, and adoption of these recommendations in the G20 Communiqué. Australia should also begin consultation towards drafting domestic legislation establishing a public registry of beneficial ownership of legal persons and arrangements.

Half of all world trade passes through tax havens, and recent research by the Uniting Church of Australia has found that 61 of Australia's top 100 companies have one or more subsidiaries in known secrecy jurisdictions.[12]

Without making allegations about any particular country or company, it is clear that lack of transparency in corporate structures afforded by use of shell companies, anonymous trusts and foundations, and the like, are a clear facilitator of individual and corporate tax evasion as well as corruption.[13] Lack of clarity around beneficial ownership also imperils Australian businesses seeking to do legitimate business overseas. If they cannot be confident of the true beneficiaries of a company, they cannot be certain that joint business ventures are not facilitating corruption.

To combat this, the Commonwealth should advocate that all OECD and G20 nations develop and maintain publicly available registers which disclosing the beneficial owners and controllers of companies, trusts and foundations as well as requiring financial institutions to establish the true beneficial owners and controllers of all corporate entities with which they do business. The Commonwealth should also begin the process of developing the domestic legislative basis for such a registry in Australia.

[11] OECD, *Automatic Exchange of Information*, 2012, p.16
[12] Wilkins and Butler, "Island Allure: The Tax Secrets of Big Business", SMH, 25 May 2013
[13] World Bank, *Puppet Masters: How the Corrupt Use Legal Structures to Hide Stolen Assets and What To Do About It,* 2011

Annex 1

The following Christian groups are the key drivers behind the campaign in Australia. They provide much of the financial support needed for the campaign and many participate in determining campaign strategy.

ACC International Relief

Act for Peace (National Council of Churches Australia)

ADRA (Adventist Development and Relief Agency)

African Enterprise Australia

Anglican Overseas Aid (formerly AngliCORD)

Baptist World Aid Australia

Caritas Australia

CBM Australia

Compassion Australia

Global Mission Partners (Churches of Christ)

Salvation Army (Australia Eastern Territory)

SIMaid

TEAR Australia

Uniting Church of Australia, Synod of Victoria and Tasmania

Uniting World

World Vision Australia