Speech to Australian Shareholders' Association Investor Conference

Second Commissioner Jeremy Hirschhorn's speech at the Australian Shareholders' Association Investor Conference.

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Large company investing – what the T(ax) says about the E(arnings)

Thank you for having me here today.

I will firstly give some background as to the health of the Australian tax system, in particular as it relates to large corporations, and the strategies of the Australian Taxation Office (ATO) in further improving that performance.

I am then hoping to highlight to you why you should be interested in the tax performance of your investee companies (and potential signals that further questions are required), as well as some other sources of information which, directly or indirectly, may help in your investment decisions and also when, as investors, you are seeking to influence the behaviours of the companies in which you invest.

Of course, I come here as a mere tax administrator, not as a tax policy maker or a financial adviser, let alone a sophisticated investor, so please take my comments in that context!

The performance of the Australian tax system is fundamentally healthy, but there is more to do

Firstly, the good news is that the Australian tax system is fundamentally healthy from an administrative perspective and compares very favourably globally. This is due in part to a competent and well-resourced administrator (I would say that!), but also due to the fact that most Australians are fundamentally honest, see the relationship between the taxes they pay and the services they seek from Government, and so willingly comply with their tax obligations (albeit not always exuberantly!).

This is not just anecdotal: the ATO dedicates significant resources to estimating the '**tax gap**', which is the difference between the tax payable according to current law and the tax actually collected. Our most recent estimates (published in our annual report each year) are that the overall system is operating at 90% performance at lodgment and 92.5% after compliance activity.

This also means that the ATO doesn't just focus on the non-compliant. The ATO puts significant effort into supporting the vast bulk of Australians (from individuals to the largest listed companies) who just want to meet their tax obligations (with as little time, cost and stress as possible) with initiatives like myTax (for individuals with simple affairs), to services for tax agents, to proactive guidance and transparency for the largest taxpayers.

In relation to large business, despite some commentary that suggests otherwise, overall performance actually exceeds the overall system, but this is after significant dedication of compliance resources. Our estimate of compliance at lodgment is circa 92% to 93%, increasing to 96% after compliance activity. By far the major driver of the large market income tax gap relates to international issues, in particular where intra-group transfers are mis-priced. Our medium to long term aspiration is to move this to 96% correct at lodgment and 98% after compliance activity.

Although in a good place, there is more to be done:

- The residual tax gap over the entire tax system is approximately $45 billion, which could pay for a lot of services.
- In relation to large companies, at least until tax performance at lodgment (92% to 93%) is higher than that of individuals at lodgment (circa 94%), ordinary Australians rightly ask the ATO to

hold large companies to account (and indeed it is healthy for overall confidence that the ATO maintains vigilance with large companies regardless of performance level).

Social licence and the silent 'T' in ESG

Tax is inextricably linked to social licence. In one sense, the tax system is really the 'sharing rules' whereby citizens come together to pool resources to fund the things that they cannot achieve by themselves. An individual or company which aggressively avoids (or worse evades) their obligations is effectively repudiating the rules of engagement of that community and puts its social licence at risk.

I refer to a speech by a colleague of mine, Faith Harako, entitled **‘Tax: the silent T in ESG'**. In that paper, Faith noted:

- at a societal level, tax pays for a lot of the 'S' and 'E' in ESG (being environment, social and governance): a company may really focus on its own S and E, but if it is not contributing fairly to the overall society’s initiatives, is it really pulling its weight?
- tax transparency gives confidence to a company’s commitment to the 'S'
- corporate tax governance is a very important part of any company’s 'G'.

So, to the extent that you, as investors, consider a company’s ESG contribution as relevant to the long-term healthiness, social licence and investability of that company, it is important not to overlook the 'silent T'.

Not so relevant today, but Faith also made the point that tax has already addressed many of the challenges of the 'E' in ESG and ESG reporting, particularly relating to differences between regimes in different countries.

Warning signs in financial statements

If you are interested in the ESG performance of your investee companies, or merely the maintainability of after-tax earnings (accounting or cash), here are a few things (not exhaustive or prescriptive!) that you may wish to consider:

Low accounting effective tax rate

A low accounting effective tax rate is not necessarily problematic of itself, but it is important to understand what is driving this, for example:

- significant operations in low (headline) tax rate jurisdictions (but even then, can that country maintain low effective tax rates?)
- significant operations in jurisdictions where tax 'holidays' are provided (are these maintainable in the longer term?)
- artificial allocation of profits to low tax rate jurisdictions ('transfer mis-pricing') (how long before one or more tax jurisdictions challenges this?) (A big clue to this one is where the company mostly operates in high tax jurisdictions but in its tax note has a substantial reduction in effective tax rate 'due to overseas operations'.)
- significant concessions under incentive schemes (e.g. patent box, **research and development** (R&D)) (are these schemes stable in the longer term in all jurisdictions?)
- tax arbitrage transactions generating 'free' deductions (e.g. intellectual property (IP) migration schemes allowing extra deductions in another jurisdiction for internally generated IP).

Normal accounting effective tax rate, but low cash tax rate

Where a profitable company discloses a relatively normal effective tax rate, but is paying minimal cash tax, it is again important to understand the drivers, some examples being:

- a 'deferred tax liability' or 'DTL' in relation to income recognised for accounting purposes (but not yet for tax) (if the earnings are not high quality enough for the tax system to tax them, are they high quality enough for your valuation models?)
- a DTL in relation to assets for accounting purposes which have been deducted for tax (unless there is an explicit accelerated deduction regime) (if the tax system thinks the benefit of the asset has been used enough to allow a deduction, what is the quality of the accounting asset?)
- a DTL in relation to profit repatriation from a low tax jurisdiction to a high tax jurisdiction (have profits been artificially allocated to (and retained in) low tax jurisdictions, and is this structuring sustainable?)

- use of deferred tax assets (DTAs) for tax losses (in the best case, the DTAs exist and can be used, but even then the cash flow benefit will be lost when they are exhausted. But how/why did the company generate the tax losses in the first place?).

Disclosure and accounting for tax disputes

We have found that disclosure and accounting for tax disputes is often opaque to investors, with different companies taking different approaches to both disclosure and quantification.

Some things to look out for and perhaps ask for more information from the company:

- a note under contingent liabilities that there is a dispute but that it is not possible to quantify it at this stage
- a part payment of an amended assessment has been paid (usually a '50%/50%'), but this is accounted for as a current receivable (effectively assuming that the matter will be fully won by the taxpayer) (the history of the ATO's disputes with large corporates is that matters, even if settled, usually result in at least the 50/50 payment being retained by the ATO)
- a note that the company has strong legal advice as to their position, and as such has made no provision for the dispute as it is more likely that the company's position will prevail (again, the ATO's track record demonstrates that these assertions are often 'optimistic')
- whether there are any 'buffer', 'hollow log' or 'tax contingency' provisions embedded in the current tax provision.

Sometimes tax disputes are a one-off but more often they are on an on-going issue (e.g. on-going pricing or mis-pricing of intra-group transfers). In these cases, the ATO will usually only settle the 'back years' if the 'forward years' are also resolved. This will usually result in increased taxation and a higher effective tax rate going forward.

Sources of insight in addition to financial statements

In addition to financial statements, over recent times we have seen an increase in tax transparency frameworks and reporting standards globally and in Australia. These frameworks provide further information to the public about the tax contribution and compliance of large business.

- Known as the **corporate tax transparency** data, annually the ATO publishes certain limited details (total income, taxable income and tax payable) of all corporate entities with a turnover of more than $100 million. The ATO publishes contextual analysis to explain the data at a population and industry level. We also update **Tax and Corporate Australia**, which is a guide about the tax landscape for large business operating in Australia.
- In a similar vein, last year we also published the first annual **R&D tax incentive (R&DTI) transparency report** providing transparency on the claims made by entities claiming R&D in the 2021–22 income year. Publishing this data encourages voluntary compliance with the requirements of the R&DTI program and increases public awareness of which companies have claimed the tax incentive.
- From mid-2026, we will see a meaningful increase in the level of tax data published in Australia with the first publication of public **country-by-country** reports. Introduced by the Government as part of its election 2022 election platform, this is a new reporting regime that will see large multinational enterprises publish selected tax information on a country-by-country basis through an ATO facilitated website. This will allow greater visibility of the global activities of multinationals as well as key tax characteristics such as where they book revenues.
- Many organisations supplement public information by voluntarily releasing a Tax Transparency Report. Developed by the Board of Taxation (a separate organisation from the ATO), the tax transparency code is designed to encourage greater transparency by the corporate sector and to enhance the community's understanding of the corporate sector's compliance with Australia's tax laws. A number of organisations can be said to have achieved global best practice with their publications and set the standard for their peers, however take-up has been limited – perhaps an opportunity for an 'if not, why not?' question at the next AGM!
- The ATO also voluntarily publishes a raft of information about our programs covering large business. Annually we publish aggregate findings reports for our assurance (**justified trust**) programs, **reportable tax position schedule**, **advice** and **disputes**. These reports show the level of compliance, prevalence of key tax risks, where we have been able to provide tax certainty for the large

market population and insights as to our disputes and how we resolve these. These reports provide deep insights into the state of large business tax compliance and the extent of ATO intervention.

I also take this opportunity to flag one particular piece of information that could be very useful to companies (and potentially their investors) in understanding where they stand on their tax affairs. Under our 'justified trust' program, we provide tax assurance ratings to the largest Australian companies, with both detailed findings and overall ratings. Under taxpayer secrecy rules, the ATO cannot separately publish these ratings, but the companies can. As a result, some leading companies are now publicly disclosing their high assurance ratings, providing confidence to stakeholders such as investors, shareholders, customers and employees. Some high-profile examples include Telstra, BHP, Woolworths, Origin and BUPA. Again, as investors (or potential investors) interested in the sustainability of an investee company's tax settings, you may wish to ask for further information about a company's tax assurance rating.

Conclusion

In summing up, it is important to understand the starting point, which is that most Australians (including most large Australian companies) are doing the right thing in relation to their tax affairs.

As investors or potential investors, whether a company is meeting its tax obligations goes to its social licence – I would argue that if a company is not contributing fairly to the community in which it operates, its social licence is at risk, perhaps in unpredictable ways.

There are a range of information sources from which an investor can glean information as to a company's tax performance and I have today suggested a few things that you might be interested in looking at and indeed asking of your investee companies.

Thank you again for the opportunity to present at today's conference and I welcome your observations or questions.

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