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Key Developments in tax administration in Australia

Deputy Commissioner Rebecca Saint delivers a speech to PacRim Conference.

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Introduction

Thank you to the Pacific Tax Policy Institute for having me at this event.

Today, I'm going to give you some insights about key developments in tax administration in Australia. There's a lot going on in Australia so I'm going to focus this discussion across four key themes that are highly relevant to the audience:

- understanding the Australian environment and the Tax Avoidance Taskforce
- specific issues update
- transparency, and
- advisor related matters.

Understanding the Australian environment

First and foremost, it is important for MNEs operating in Australia to understand the tax landscape and environment in Australia. The

cultural, political and economic settings in Australia mean that tax performance of big business is a community issue that attracts significant political and media interest.

Cultural settings

Australia has a strong cultural ethos that emphasises the importance of fairness and integrity. Australia also has a highly educated population with high levels of financial literacy. The combination of these two factors, mean we have a community that has a keen interest in ensuring that big business is meeting their social contract in terms of economic contribution.

In around 2014–2015, there was community outrage in Australia at the perceived lack of economic contribution by big business. Whilst Australia was not unique in this at the time, the intensity and interest in multinational taxation has not subsided. In 2015, we saw some intense parliamentary inquiries exploring multinational tax issues (ultimately culminating with the adoption and pragmatic implementation of BEPs and BEPs supportive measures). We also started to see tax featuring in mainstream media in a way that we hadn't before. The Australian community is interested, well informed and you can see this playing out in Australian politics even now, ten years on.

It is important that the Australian community has confidence in the fairness of the tax system. The health of the whole tax system is indirectly influenced by the perceived tax performance of large business. The willingness of individual and small business taxpayers to voluntarily meet their tax obligations is indirectly impacted by whether they consider there is fairness in the system.

Revenue collection

Corporate tax receipts in Australia accounts for around 23% of total Government revenue. This compares to an OECD average of 10%. Corporate tax is highly concentrated in a few entities. The largest 10 pay around 30% of all corporate tax (so about 7% of total Government revenue), the largest 100 around 50% and the large corporate group population around 65% of total corporate tax. This concentration means that movements in tax positions of even a small number of entities can have a significant impact on tax collections. Worse, proliferation of material tax risk in this population can have significant detrimental impacts on revenues.

The combination of Australia as a capital importing country with a high tax rate, makes us highly susceptible to profit shifting.

Today we also published the latest data from our **International related party dealings statistics 2021–22**. This data provides key statistics sourced from processed **international dealings schedules** and **local file – part A** lodgments for the 2021–22 and earlier income years.

The ATO focus on the risk of 'transfer mis-pricing' (as contrasted from 'transfer pricing', an essential part of the system) and mischaracterisation of cross border related party dealings is illustrated from one simple comparison: Australia's three biggest trading partners from a 'real' trade perspective are China (27%), Japan (11%) and USA (7%). However, in terms of contractual dealings with related parties, Singapore, with its lower headline tax rate, is at 34%, the USA is at 13% and Japan 7%. China is only 3%.

This explains why the Australian Government and the ATO continue to invest in tackling cross-border related risks to such a degree. To give some more colour to this, profit shifting disputes continue to make up a significant part – roughly 70% – of the audit book for public and multinational businesses.

The high concentration of corporate tax, susceptibility to profit shifting and detrimental impact of possible proliferation mean that Australia must be hyper vigilant around the international tax settings for multinationals.

Taskforce update

Successive governments have funded the ATO to establish and maintain the Tax Avoidance Taskforce, with the purpose of investigating and challenging tax avoidance arrangements, and to improve the tax performance of big business more generally.

In the recent Federal Budget, Government has continued this commitment, extending the Taskforce for a further 2 years to years until 30 June 2028 providing an additional $1.2 billion in funding. This funding is tied, ensuring that the ATO delivers on Government commitments to tackle tax avoidance of the largest public and private businesses in Australia. Since establishing in July 2016, the Taskforce has contributed to raising more than $30 billion in liabilities.

But it's not all about audit yield. We have a significant focus on helping taxpayers get their tax outcomes right on lodgment and sustaining this

into the future. Our tax gap analysis (which measures the difference between what was collected and what should have been collected) shows that we have made improvements in lifting performance on lodgment. Gross tax performance, has improved from around 91% in 2010–2011 to around 93.5% for 2020–21. This means we collect 93.5% of tax on lodgment. A 2.5% improvement may not seem much, but that is around $2 billion additional tax paid each year without further ATO intervention. Overall performance increases to 96% after ATO intervention. In the medium term, we are aiming to increase gross tax performance to 96% on lodgment and 98% following ATO intervention (noting that no tax system can ever realistically achieve 100% performance).

Our justified trust program has played a key role in this improvement. This program is directed at assuring the tax outcomes of the largest public and private businesses in Australia. Specifically, funded through Taskforce, this program is designed to give the community confidence that we are reviewing all large businesses and they are being held to account.

Assuring business outcomes means we verify all aspects of the business, not just where we might identify tax risk using traditional risk models and approaches. Continual close monitoring of these groups through an assurance approach gives us high levels of confidence that we know which businesses are meeting their Australian tax obligations and those that are not. It has removed any element of detection risk as all aspects of business are reviewed.

We have also sought to provide high levels of transparency to taxpayers about areas of concern and our risk parameters. For example, practical compliance guidelines externalise or make public our compliance risk parameters. Publishing these parameters allows taxpayers to understand the risk that their arrangement may be subject to further investigation. On this basis, taxpayers are able to make informed decisions about their compliance risk and importantly, can avoid ‘surprise’ disputes.

Positively, and as can be demonstrated by an overall performance level of around 96%, through the work of the Taskforce we have confidence that most large businesses are meeting their Australian tax obligations. However, some large businesses continue to engage in profit shifting and tax avoidance activities. As we are changing and locking in improved behaviours of taxpayers (for example as part of our

settlements), we are moving through the population and getting to businesses that previously we may not have been able to.

Specific issues

I want to turn now to provide an update about some issues highly relevant to the audience today, being intangibles and Pillar Two.

Intangibles and mischaracterisation of payments

The ATO has been concerned with the proliferation of arrangements involving intangible migration and the mischaracterisation of payments in connection with intangible assets.

This culminated in the issuance of a number of guidance materials, including most recently PCG 2024/1, which deal with migration of intangible assets/mischaracterisation and non-recognition of Australian activities connected with those assets. This guidance allows taxpayers to self-assess the risk that they might be subject to compliance activity in relation to their intangible migration arrangements.

We have also issued Taxpayer Alert 2018/2, where we outlined our concerns as to whether intangible assets have been appropriately recognised for Australian tax purposes and whether Australian royalty withholding tax obligations have been met.

Since then, we have issued draft software rulings, the latest of which is Taxation Ruling 2024/D1. This ruling has attracted considerable attention from some US companies and stakeholders in particular. It is important to note that the view in the draft Ruling is longstanding and reflects the decision of Australian courts in IBM Corporation, handed down as long ago as 2011. The revised ruling applies the ATO's view to modern forms of software distribution, including 'software as a service'.

The revised ruling provides detailed explanation of our consideration of the meaning of copyright as relevant to the definition of royalties in our domestic law and our treaties. We acknowledge there are differing views about the application of copyright law (which has itself changed over time) to the facts of modern software distribution arrangements, and the secondary, but critical, issue as to how much of a payment is for the use of that copyright.

At present we are focussed on finalising our views, having regard to feedback received in consultation earlier this year. We received more than 20 submissions and met with a number of consultees. We are considering possible revisions to the draft ruling and anticipate taking the matter back to our Rulings panel (which includes former Federal Court judges). We want to thank everyone for their feedback. It is important to us to receive your views. We will provide a compendium of comments that sets out where we have made changes as a result of feedback and also where and why we may not have accepted your view.

We are aiming to issue a final ruling by the end of the calendar year. Whilst we anticipate some revisions, as I noted a second ago, we accept that there are some issues which we and some stakeholders will not agree on. Of course, the ATO does not make tax law, it only expresses its considered opinion. Ultimately the courts decide, and so an opportunity for judicial consideration of the issues by an Australian court would be welcomed by the ATO.

As a result of feedback, in parallel, we are working on draft administrative guidance, likely to be a practical compliance guide (PCG). The PCG will focus on the practical implications of the view in the ruling. This guidance is intended to address, in a practical way, some of the difficult issues around apportionment, evidentiary requirements and the ATO's compliance approach to the (mis)characterisation of royalty payments. We will consult on this draft guidance and are aiming to release a draft later this calendar year. We welcome your views and input as part of the development of this guide.

Diverted profits tax (DPT)

The DPT provides the Commissioner with greater powers to deal with large multinationals using artificial or contrived arrangements to divert profits offshore. The DPT is not a law specifically aimed at those in the digital economy or intended to extend our taxing rights but operates as an integrity measure to protect our tax base.

The DPT is a penalty tax; imposing a penalty tax rate of 40% on the profits diverted offshore so is punitive by design. Whilst we have considered the DPT in varying contexts, to date it has only been judicially tested in the context of mischaracterised payments (often referred to as embedded royalties).

The decision at first instance in the PepsiCo matter is our first insight into how a court may approach the DPT provisions. Whilst it was ultimately unnecessary to consider the DPT issue in light of the conclusion that the royalty withholding tax provisions applied, for the sake of completeness the Court considered that it would have otherwise concluded that the DPT provisions applied.

Whilst the DPT provides another option to the ATO to tackle tax avoidance, it is a provision that continues to be applied sparingly. We have considered the potential application of DPT in over 500 cases, with only two cases proceeding to assessment stage. Currently we have around 10 cases where we are actively considering the application of the DPT. I make a couple of observations about why this is the case:

- Positively, since the DPT was introduced, we have observed an increased willingness of taxpayers to address ATO concerns about their structures (not just pricing).
- We do not make the decision lightly to move to a DPT pathway. The DPT pathway differs from that of the usual assessment process. It provides an expedited audit period, with a more direct route to court. As noted earlier, it is a punitive tax rate, and we also require full payment by the taxpayer on receipt of the final assessment (even if disputed).

Given the limited instances where the ATO has sought to apply the DPT, if the ATO team tells you that they are considering applying the DPT, you should take this very seriously, and consider reviewing your arrangements and making necessary changes if you wish to avoid a DPT assessment. It is also a good opportunity to take stock as to how you and your advisor are providing information to, and interacting more generally with, the ATO. I note that compensating Australia through a pricing 'fix' (for example, where Australia is made whole through a transfer pricing adjustment) will rarely be sufficient to address structural concerns. We will be looking for lasting change that can typically only be produced through structural changes to legal arrangements.

Data centres

In light of the evolving digital landscape, we have observed growth over the last decade in the cloud computing and data-hosting industry. We expect this trend to continue with billions of dollars of planned

investment in Australian data centres to be owned or leased by foreign multinational groups.

With the increasing demand for cloud services by Australian customers, and the emergence of AI, it appears to be commercially desirable for multinationals to build more data centres in Australia to service the Australian market and the region. We understand that data centres located in Australia are of critical importance in order to reduce latency and for data security/reliability/sovereignty requirements.

Concerningly, we have seen some multinationals claim the Australian data centre entities provide low value services for the offshore group. However, our perception is that the Australian activities and data centre assets, and their physical location in Australia, are a more fundamental and valuable part of the broader enterprise.

The tax outcomes and structuring of these large-scale Australian data centre activities is therefore an emerging issue. We are essentially considering whether profits currently being returned in Australia appropriately reflect the value of the large-scale data centres in Australia, and/or whether there is the use in Australia of IP (including software platforms and brands) held offshore giving rise to royalty withholding tax obligations. These considerations also require us to turn our minds to the appropriateness of the structuring adopted in Australia.

Our focus is on whether:

- foreign entities in the multinational groups have a taxable presence in Australia, for example, by way of Permanent Establishments (PE) – e.g. having a fixed place of business in Australia through large-scale data centres;
- the structure of the Australian group and whether the fragmentation of the Australian activities (including large scale data centres) into separate legal entities is for the purpose of reducing Australian tax and subject to the GAAR (i.e. avoidance of a permanent establishment to which profits and/or royalty expenses would be attributable and therefore taxable in Australia, or to mischaracterisation of integrated business activities for transfer pricing purposes);
- payments made by Australian subsidiaries of the multinational groups do not appropriately reflect the use or right to use IP or

other intangible assets which would result in a liability to Australian Royalty Withholding Tax.

We are currently reviewing a number of these arrangements to assess whether they artificially bifurcate or separate what are actually integrated business activities for the purpose of reducing or avoiding Australian tax. We are yet to form a final view.

Pillar Two

The GloBE and DMT measure was announced as part of the May 2023 Federal Budget and is effective from 1 January 2024 for both the Income Inclusion Rule and the Domestic Minimum tax. On 21 March 2024, the Commonwealth Treasury released exposure draft materials consisting of primary legislation, subordinate legislation in the form of Rules, and accompanying explanatory materials. Treasury public consultation on the primary legislation closed on 16 April 2024 and for the subordinate legislation consultation closed on 16 May 2024.

A dedicated ATO Implementation Team has been established to oversee the implementation of the measure, including:

- developing our client engagement approach (including lodgment considerations)
- supporting the Treasury with law design
- providing guidance to and connecting with in-scope MNEs and advisors
- developing systems to allow for lodgment and exchange of the GloBE information return (GIR) and associated forms
- developing our data and analytics capabilities.

Pillar Two is not expected to generate significant revenue for Australia. The May Federal Budget estimates that revenue generated by the measure will be $160 million in 2025–26 and $210 million in 2026–27. The ATO has been allocated approximately $110.5 million over a 4-year period to implement and administer the measure, recognising the significant IT build associated with the measure.

Based on current profiling we estimate that there are approximately 6000 MNE groups with Australian operations in scope of the measure. Of these approximately 135 are Australian headquartered with the remainder foreign headquartered.

We have been focussed on developing the systems required to administer the measure in advance of the first lodgements which are due earliest on 30 June 2026. In particular we are focusing on the systems needed to facilitate the global exchange of the GIR.

However we have also been engaging with stakeholders to understand what assistance they will need in meeting these obligations. For example, we have started to engage on what topics will require guidance from the ATO.

We are also developing our client engagement strategy taking into account feedback from consultation. We understand the significant compliance burden for in-scope taxpayers, and will be seeking to apply transitional relief (including in respect of penalties) in accordance with OECD administrative guidance.

That is, it is our intent that no penalties or sanctions should apply during a transitional period in connection with filing GloBE Information Returns where an MNE has taken reasonable measures to ensure the correct application of the GloBE rules. Noting the importance of this for taxpayers, guidance confirming our approach to penalties is a priority topic.

In the lead up to the first lodgment due date, client engagement activities will be focused on supporting clients to get the 'basics right' in terms of lodgment and payment obligations. This will be done through education / awareness initiatives, such as targeted communications to be delivered in accordance with the Pillar Two communications strategy.

Following receipt of the first incoming lodgments, targeted GloBE reviews are expected to be conducted, taking a risk-based approach. We don’t propose to undertake a justified trust or assurance approaches at least in the initial years. That said, I must take this opportunity to stress one emerging concern: we are aware of currently low tax rate countries proposing regimes which would subvert the intent of the GloBE rules of actually imposing a minimum corporate tax rate. If such regimes survive the consensus process, I would expect the ATO and other high tax rate countries to stress test the effectiveness of these regimes in subverting the intent, and companies should be extremely cautious in relying on these countries to “solve” their GloBE exposures.

Transparency

Transparency is a key factor underpinning public confidence in the integrity of the tax system. The ATO provides a significant amount of information to the public about the performance and health of the tax system. In addition to tax gap, we annually publish a raft of information that provides insights about the tax performance and compliance of big business. This includes:

- *Corporate tax transparency data* – provides limited details (3 data points) at a taxpayer level. Whilst this data can provide some insight in relation to specific entities, the limited data fields means are not well suited to understanding the tax profile of entities. A number of entities publish complementary material to explain the 3 numbers. 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.
- *Findings reports for our justified trust programs, reportable tax position schedules, private rulings and settlements* – 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 to settlements.

This information has gone some way to improving community understanding of the tax performance of big business. There is general recognition that the ATO has a good handle on which groups are meeting their tax obligations and is able to take firm action with those that aren't. However, the community wants to itself be able to understand and differentiate tax performance at an organisational level.

In 2015, the Board of Tax introduced the voluntary tax transparency code (VTTC), which was endorsed by the Australian Government in 2015–16. Around 200 organisations have signed up to the regime, annually publishing insights into their tax profiles, some even publishing CBC data. However, the take up of 200 falls well short of the 1,500 groups that sit in our large market population and is largely dominated by Australian corporates. There has also been varying quality of reports published.

The Australian Government is now seeking to enhance the transparency of information of MNEs to the Australian public, through the public CbC regime. Currently before Parliament, the proposed public CbC laws require large MNEs with a presence in Australia to

annually provide the ATO certain tax and financial information; some of which will be on a country-by-country basis, which the ATO is in turn required to publish. The MNEs will also be required to include a statement on their approach to taxation.

The Government has announced a start date of 1 July 2024. Entities are required to provide the ATO with relevant information within 12 months of the end of the relevant financial reporting period. This effectively means that the ATO will not be publishing these reports for around 2 years.

Of course, we appreciate that MNEs will need to understand and prepare for this obligation. If and when the Bill is passed we will consult with stakeholders on how we plan to administer the regime, as well as on priority areas where MNEs may need ATO guidance.

Without limiting the scope of this consultation, we anticipate that ATO discretion to grant exemptions will likely be raised by many as a priority. In particular, when and how we will exercise this discretion. Whilst it's too early to announce any formal position on this given the Bill is yet to be passed by Parliament, I do note that the ATO will need to administer the law having regard to the underlying policy intent of public transparency. Any decision to grant exemptions will need to be considered with this at the forefront.

It will be interesting to see if public CBC will also drive voluntary transparency through other means (for example, the VTTC or sustainability reports as part of ESG) as organisations seek to publish contextual information to better explain data included in the CBC data.

Advisors

The ATO recognises, the key role that advisors play in the tax system in supporting taxpayers to meet their tax obligations. Most firms and their staff are operating ethically but we have seen global events, including events in Australia that have put pressure on this.

Recognising the critical role of advisors, the ATO has been focussed on the role of advisors in supporting big business. We have a dedicated team in the Taskforce with responsibility for monitoring and addressing advisor behaviours of concern. Key areas where we have sought to influence advisor behaviour include:

- the misuse and abuse of legal professional privilege in an attempt to withhold information from the ATO to obfuscate investigations

- the promotion and marketing of tax avoidance or other high risk arrangements; and
- false and misleading statements (either directly or by omission) in response to requests for information.

In response, the ATO has undertaken a number of key initiatives:

1. **Large Market Advisor Principles (the Principles)** – The ATO worked closely with the Big 4 advisory firms to facilitate the development of the Principles. The Principles provide an objective and transparent basis against which firms, their clients and the community, can be confident that the firms are not engaged in marketing or promotion of tax avoidance or other high risk arrangements. The Principles were published and adopted by each of the Big 4 in August 2022. Each year the firms publish a conformance statement. Compliance must be independently verified every 3 years.
2. **LPP protocol** – The ATO published the LPP protocol as a best practice guide to supporting LPP claims. We want taxpayers to get high quality legal advice and support LPP as a fundamental common law right. However, we observed practices that were at best lax and at worst deliberately designed in an attempt to withhold information. Following the LPP protocol allows the ATO, business and their advisors to gain confidence about LPP claims and processes.
3. **International & Regulatory Engagement** – we continue to work with international and domestic standard setters (for example IESBA and APESB) to ensure that standards continue to meet community expectations. Following the conclusion of the standards on tax planning IESBA is now embarking on considering standards for firm culture and governance. We also work with our international counterparts through forums such as the Large Business 5 to further work directed at disrupting advisor behaviours that support or facilitate tax avoidance internationally.

Law reform is also at the forefront in Australia for tax practitioners and consulting firms generally. Following the revelations of misconduct involving partners of PwC, we have seen a raft of new measures and reviews announced by the current Government. Relevantly, this includes the widening of the promoter penalty provisions and the increase in penalties to a maximum of $780 million for corporates and SGEs. The Attorney General's Department is undertaking a review of

LPP. There are a number of other reviews or reforms underway related to regulatory reform of the sector, secrecy provisions, whistleblowers and fraud.

There have also been a number of wide-ranging Federal and State Parliamentary inquiries in relation to the consulting firms. This week we saw the Consulting Inquiry hand down its report delivering a number of recommendations directed at the consulting sector.

Conclusion

For the past decade, Australia has been at the forefront of the global fight against multinational tax avoidance. Successive Governments from both sides of the political persuasion have made significant investments in the ATO and also law reform initiatives. These measures have greatly increased the ability of the ATO to identify transfer pricing and other BEPS risks and take firm and decisive action against MNEs that have not been paying their fair share of tax in Australia.

We have seen improvements in the tax compliance of large business and have increasing confidence that most large businesses are meeting their tax obligations. However, we still aim for further improvements as well as ensuring that we can lock in desired behaviours into the future.

Post Script: On 26 June 2024, the Full Federal Court handed down its decision in *PepsiCo, Inc v. Commissioner of Taxation [2024] FCAFC 86* in favour of the taxpayer. The ATO has lodged a special leave application with the High Court of Australia.

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