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Via e-mail – anne.vandenhurk@treasury.gov.au

Dear Anne

Treasury Laws Amendment (Combating Multinational Tax Avoidance) Bill 2017: increasing penalties for significant global entities

The Corporate Tax Association (CTA) welcomes the opportunity to comment on the *"Treasury Laws Amendment (Combating Multinational Tax Avoidance) Bill 2017: increasing penalties for significant global entities"* Exposure Draft (ED) and accompanying Explanatory Material (EM).

Whilst the CTA and its members fully acknowledge that the legislative intent to encourage significant global entities (SGE) to better comply with their tax obligations, particularly in the context of claims of multinational tax avoidance and evasion, it is our view the ED which increases failure to lodge (FTL) penalties by 100fold for all approved forms and doubles penalties for shortfalls where a SGE has taken a position that is not reasonably, is going beyond the Government's original intent with the measures as announced in the 2016-17 Budget Papers.

We have also attached as an appendix our letter of 3 June 2016 sent to Simon Duggan shortly after the May 2016 budget.

The Draft Bill goes beyond the Government's intent

1 The Draft Bill impacts Australian controlled groups with no foreign operations

On 3 May 2016, the Government announced the Tax integrity package – increasing administrative penalties for significant global entities where it states (emphasis added):

> The Government will increase administrative penalties imposed on companies with global revenue of $1 billion or more who fail to adhere to tax disclosure obligations. This measure will apply from 1 July 2017 and is estimated to have an unquantifiable gain to revenue over the forward estimates period.
>
> Penalties relating to the lodgement of tax documents to the Australian Taxation Office (ATO) will be increased by a factor of 100. This will raise the maximum penalty from $4,500 to $450,000, which will help to ensure that **multinational companies** do not opt out of their reporting obligations.
>
> Penalties relating to making statements to the ATO will be doubled, to increase the penalties imposed on **multinational companies** that are being reckless or careless in their tax affairs.
>
> This measure forms part of the Government's Tax Integrity Package, which will strengthen the integrity of Australia's tax system.

It is submitted the intent behind the Governments' proposal is to ensure **multinational companies** (those Australian groups that are controlled by non-residents and Australian groups that have foreign operations) should be subject to the increased administrative penalties and not SGEs that are controlled by Australian residents and only have Australian operations. The distinction is significant and important as the ED applies extremely widely, impacting Australian controlled groups operating solely in Australia where there is no potential loss of revenue from mispriced international related party transactions. For example, Australian listed trust groups, including listed Real Estate Investment Trusts, would be caught up in the proposed definition of SGE.

In our view, increasing FTL penalties by 100fold for such groups is going far beyond the intent with the FTL proposal as such entities have no exposure to misstatements of their tax obligations because of international dealings. It is recommended that SGEs that are controlled by Australian residents and have no foreign operations be excluded from the measure. The existing penalty regime operates as a sufficient deterrent for any non-compliance by domestic entities and should be left undisturbed by these changes.

2 The measure applies to any approved form

As the proposed measure is currently drafted, FTL penalties apply to any approved form that may be required to be lodged under a taxation law and not solely returns such as income tax returns, BAS, PRRT or country by country reports which may have a bearing on the calculation of a tax liability.

According to the summary of the measure outlined in Tax Fact Sheet 2 – "Ensuring Businesses Pay the Right Amount of Tax"[1] the proposed measure:

> " .. will increase the penalties for breach of tax reporting obligations for companies with global revenue of $1 billion or more. The Government will increase the maximum penalty for failing to lodge on time tax returns, business activity statements, country-by-country reports and similar tax documents – from $4,500 to $450,000...."

It is submitted that the intent of the provision is to apply to certain approved forms such as tax returns, BAS, income activity statements and country by country reports and not to <u>all</u> approved forms. In our view "similar tax documents" in the context of the proposed 100fold penalty increase should be limited to approved forms that are integral to the ATO in reviewing tax liabilities and should not apply to approved forms that are more in the nature of information. The latter group should remain subject to the existing FTL penalties. By way of example, as the ED currently operates, a SGE could be subject to a 100fold increase in FTL penalties for failing to notify the registrar of the Australian Business Register within 28 days of a change in an email or postal address under Paragraph 14(2)(b) of *A New Tax System (Australian Business Number) Act 1999* which is the same penalty as applying to failing to lodge an income tax return or country by country report.2 Whilst it is recognised that lodging tax documents is an integral part of the tax system, to impose FTL penalties, albeit potentially subject to remission, on approved forms that do not go to the calculation of an ultimate tax liability, is unreasonable and not commensurate with the issue at hand or the Government's stated intent.

3 The doubling of penalties for positions that are not reasonably arguable appears inconsistent with the Government's intent

As mentioned in the EM at paragraph 1.5, the 2015 Act was amended to double the penalties that applied to SGEs for entering into tax avoidance and profit shifting schemes and was specifically not extended to other arrangements that created a tax shortfall, particularly where there was a reasonably arguable position.

As was mentioned in the 2015-16 Budget Paper No. 2:

> "The Government will double the maximum administrative penalties that can be applied by the Commissioner of Taxation to large companies that enter into tax avoidance and profit shifting schemes. The increased penalties, under Schedule 1 to the Taxation Administration Act 1953, will help to deter tax avoidance and will apply for income years commencing on or after 1 July 2015. This measure is estimated to have an unquantifiable gain to revenue over the forward estimates period.
>
> ***Penalties will not change for taxpayers who have a 'reasonably arguable' tax position, as defined under Schedule 1.***" *(emphasis added).*[3]

Moreover in 2016-17 Budget Paper No. 2 it is stated that:

> "Penalties relating to making statements to the ATO will be doubled, to increase the penalties imposed on multinational companies that are being **reckless** or **careless** in their tax affairs." (emphasis added).

It is submitted the intent outlined in the 2016-17 Budget announcement is similar to that of the 2015 amendments, with the doubling of penalties only applying to cases where there is intentional, reckless or careless behaviour and not to circumstances where a SGE has taken a position which is ultimately viewed by the Commissioner as not reasonably arguable.

The Commissioner's discretion to remit penalties

Whilst recognising that section 388-55 of the Taxation Administration Act 1953 (TAA) allows the Commissioner to defer the time for the provision of an approved form, the working presumption in the current law is a FTL penalty is automatically imposed, and requires the Commissioner to exercise his discretion to remit such penalty.[4]

What this means in practice is ATO systems operate in such a way that penalties are automatically generated, thereby requiring work from both the taxpayer and the ATO to consider remission, even in the simplest of cases of late lodgment. Although a taxpayer may request a time to defer lodgment, practical issues will arise when lodgments are unknowingly late (such as a recently dormant entity, a nominee trustee, or a change of email address) or matters arising that are beyond the taxpayer's control. These circumstances stand in stark contrast to those where there is an intentional, reckless or careless late lodgment of an approved form.

Whilst it is recognised that the proposed subsection 286-80(4C) of the TAA does not limit the operation of section 298-20 of the TAA, and that amounts may be remitted, it is disappointing that the amount of the FTL penalty in itself will not be a relevant factor in the question of remission (see paragraph 1.27 of the EM). To put this in context, the FTL penalty for intentionally failing to lodge a tax return by one month would be $90,000 whereas the inadvertent failure to lodge a notification of a change in an email address by

2 months would be $180,000. In our view, given the 100fold increase in FTL penalties, along with the fact that they apply to all approved forms under the current ED, consideration of the amount of the penalty of itself should be a consideration in its remission. Although the ATO has indicated in its guidance that SGE's will receive a reminder for an earlier breach before they incur an FTL penalty, we also recommend that the ATO devote specific resources to deal with requests for remission where FTL penalties are imposed on SGEs under the proposed provisions.

Conclusion

When formulating changes to the tax law to combat tax avoidance or to discourage non-compliance, consideration must be given to the vast majority of large taxpayers who do comply with the law, who do engage constructively with the ATO and do pay the appropriate amount of tax. Measures aimed at those taxpayers who fall outside these parameters should not encroach on those that operate within them.

Although we support the Government's proposed policy of discouraging blatant breaches of tax reporting obligations, the sheer breadth of the proposed changes to the FTL and penalty provisions contained in the ED go beyond penalising those few SGEs that engage in such activity. Rather, the proposed amendments will effectively capture all SGEs, regardless of their lodgment history, type of approved form and whether they have taken reasonable care. In our view this outcome is contrary to the Government's stated intent.

It is also understood that these rules were designed specifically to capture large multinationals. A large multinational has a different tax profile than that of an Australian domestic enterprise, whether structured as a corporation or a trust. As a matter of public policy, multinationals should not be grouped with wholly Australian entities (even if they are SGEs) with no international dealings or transfer pricing tax risk. In this regard, the existing penalty regime should be left undisturbed for wholly Australian SGEs.

The CTA would welcome the opportunity to discuss the above with you to ensure the proposed amendments to the penalties regime are aligned with the Government's intent and that those that operate within the boundaries of the existing law are not inadvertently affected by the proposed changes.

Should you have any questions, please do not hesitate to contact either Paul Suppree or me.

Regards

Michelle De Niese
Executive Director

[1] See: http://budget.gov.au/2016-17/content/glossies/tax_super/downloads/FS-Tax/02-TFS-Ensuring_businesses_pay_their_fair_share.pdf

[2] A complete listing of current approved forms can be found at: https://www.ato.gov.au/Tax-professionals/TP/Consolidated-list-of-approved-forms-by-tax-topic/

[3] See: http://www.budget.gov.au/2015-16/content/bp2/html/bp2_revenue-07.htm

[4] The Commissioner has issued a guidance on "failure to lodge on time" penalties and the exercise of his discretion which can be found at: https://www.ato.gov.au/business/business-activity-statements-(bas)/in-detail/lodgment-and-payment/failure-to-lodge-on-time-(ftl)-penalty-faqs/. Practice Statement PSLA 2011/15 provides more details on the specifics of the exercise of the Commissioner's discretion. See http://law.ato.gov.au/atolaw/view.htm?docid=PSR/PS201115/NAT/ATO/00001

3 June 2016

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Dear Simon

Proposed Late Lodgment Penalty Regime for Significant Global Entities

I refer to our recent conversation around the Budget announcement to increase by 100fold penalties for late lodgment of tax documents for significant global entities (SGEs). Note that the CTA does not have any concern with the doubling of penalties for false and misleading statements as proposed.[5]

According to the summary in Tax Fact Sheet 2 – "Ensuring Businesses Pay the Right Amount of Tax"[6] the proposed measure:

> " .. will increase the penalties for breach of tax reporting obligations for companies with global revenue of $1 billion or more. The Government will increase the maximum penalty for failing to lodge on time tax returns, business activity statements, country-by-country reports and similar tax documents – from $4,500 to $450,000. **This will significantly discourage breaches of tax reporting obligations**. The Government will also double the penalties for making false and misleading statements to the ATO in relation to various obligations under the tax law. **These new penalties will send a clear message that the Government will not tolerate inaccurate or delayed tax reporting and administration by large businesses**. ... This measure has an unquantifiable gain to revenue." (emphasis added)

Background – The Current Late Lodgment Penalty Regime

As you are aware section 286-75 of the *Tax Administration Act 1997* (TAA) currently imposes an administrative penalty if a taxpayer is required to give a return, notice, statement or other document in an "approved form" by a particular day and does not lodge by that day. The provision operates such that similar penalties are also imposed if a taxpayer is required to give a statement under:

- Division 390 (Superannuation member information statements)
- Division 391 (First Home saver account reporting)
- Division 392 (Employee Share scheme reporting)
- The happening of an event under section 713-540 of the Income Tax (Transitional Provisions) Act 1997 (certain deferral events in connection with member life insurance companies)

Under subsection 286-75(6) of the TAA any such penalties also make directors of a body corporate jointly and severally liable to the penalty.[7] Under section 286-80(4) of the TAA penalties for large taxpayers (those with turnover of more than $20 million) are currently up to 25 penalty units (at $180 per penalty unit) to a maximum of $4,500. On a daily basis, this is equivalent to a penalty of approximately $32 per day for late lodgment of an approved form. Late lodgment penalties are imposed regardless of whether any amount is due and payable on the lodgment of an approved form and can be imposed where a refund is due. The definition of "approved form" is extremely wide and there are currently a voluminous number of approved forms, ranging from Business Activity Statements (BAS), income tax returns and associated forms, to FATCA reporting, FBT returns and Wine Equalisation Tax to name but a few. [8]

Prima facie the 100fold increase in late lodgment penalties will increase the daily late lodgment penalty to approximately $3,200 for any approved form. It is worth noting that in some cases, such as a BAS, more than one amount is reportable with each reportable amount being a separate disclosure. The current BAS has seven reportable numbers, so prima facie, the daily penalty for the late lodgment of a BAS could be as high as $22,400, even if no amount is due on the BAS.

Whilst recognising that section 388-55 of the TAA allows the Commissioner to defer the time for the provision of an approved form, the working presumption in the current law is a late lodgment penalty is automatically imposed, and requires the Commissioner to exercise his discretion to remit such penalty. [9]

What this means in practice is that ATO systems operate in such a way that penalties are automatically generated, thereby requiring work from both the taxpayer and the ATO to consider remission, even in the simplest of cases of late lodgment. Although a taxpayer may request a time to defer lodgment before the due date for lodgment, practical issues arise when lodgments are unknowingly late (such as a recently dormant entity, or a nominee trustee) or matters arise that are beyond the taxpayer's control. These circumstances stand in stark contrast to those where there is an intentional or reckless late lodgment of an approved form.

Scope of the problem of late lodgment

Whilst we recognise the intent of the proposed amendments is to encourage timely lodgment and discourage breaches of tax reporting obligations, it is worth noting that the current level of lodgment compliance for large taxpayers is extremely robust. The ATO in its recent submission to the Senate Inquiry into Corporate Tax Avoidance noted the following at paragraph 105:

> *"More than 74% of corporate entities lodged their income tax return and business activity statements on time with more than 86% paying their income tax liability on time. **For large businesses, 95.1% of large businesses paid their tax on time, with 98.4% paying within 90 days of the due date".***[10] (emphasis added)

Understanding the policy intent

The policy underpinning the proposed changes to late lodgment penalties for SGEs is clear:

- to significantly discourage breaches of tax reporting obligations; and
- to send a clear message that the Government will not tolerate inaccurate or delayed tax reporting and administration by large businesses.

The CTA supports the Government's interest in ensuring that SGEs meet their tax obligations in a timely manner. We also agree that inaccurate or delayed tax reporting and administration by large business is not acceptable and should be addressed.

Conclusion

Although we support the Government's proposed policy of discouraging blatant breaches of tax reporting obligations, the sheer breadth of the proposed changes to the late lodgment provisions will go well beyond penalising those few SGEs that engage in such activity. Rather, the proposed amendments will effectively capture all SGEs, regardless of their lodgment history. The statistics on lodgment compliance for large corporates as set out on the previous page clearly illustrate that this outcome is unjustified.

Although we understand late lodgment penalties are subject to remission, where the penalty is a non-tax deductible amount of $3,200 per day, the Government can expect to see a significant amount of unwarranted reverse workflow to the ATO as taxpayers seek remission even for the simplest of oversights.

When formulating changes to the tax law to combat tax avoidance or to discourage non-compliance, consideration must be given to the vast majority of large taxpayers who do comply with the law, who do engage constructively with the ATO and do pay the appropriate amount of tax. Measures aimed at those taxpayers who fall outside these parameters should not encroach on those that operate within them.

The CTA would welcome the opportunity to work constructively with Treasury and the ATO to ensure that the Government's stated policy objective in introducing the proposed amendments to the penalties regime are met and that those that operate within the boundaries of the existing law are not inadvertently affected.

Should you have any questions, please do not hesitate to contact either Paul Suppree or me.

Regards

Michelle De Niese
Executive Director

CC: Assistant Treasurer the Hon Kelly O'Dwyer MP
Second Commissioner Andrew Mills

[5] Penalties could increase to up to 120 penalty units for false or misleading statements described in subsection 284-75(1) or (4) of the TAA.

[6] See: http://budget.gov.au/2016-17/content/glossies/tax_super/downloads/FS-Tax/02-TFS-Ensuring_businesses_pay_their_fair_share.pdf

[7] We note this may result in increased director liability insurance premiums or encourage more directors to takeout such policies where they have not in the past.

[8] A complete listing of current approved forms can be found at: https://www.ato.gov.au/Tax-professionals/TP/Consolidated-list-of-approved-forms-by-tax-topic/

[9] The Commissioner has issued a guidance on "failure to lodge on time" penalties and the exercise of his discretion which can be found at: https://www.ato.gov.au/business/business-activity-statements-(bas)/in-detail/lodgment-and-payment/failure-to-lodge-on-time-(ftl)-penalty-faqs/. Practice Statement PSLA 2011/15 provides more details on the specifics of the exercise of the Commissioner's discretion. See http://law.ato.gov.au/atolaw/view.htm?docid=PSR/PS201115/NAT/ATO/00001

[10] http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Corporate_Tax_Avoidance/Submissions