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EY Submission – Exposure draft law to increase penalties for significant global entities

Dear Sir / Madam

EY welcomes the opportunity to provide comments in relation to the 20 December 2016 Exposure Draft Bill *Treasury Laws Amendment (Combating Multinational Tax Avoidance) Bill 2017: increasing penalties for significant global entities* ("**the Penalties Exposure Draft**" or "**PED"**) and the accompanying explanatory material (**EM**).

The PED relates solely to increased penalties for obligations for lodgment of materials with, and in relation to certain statements made to, the Australian Taxation Office (ATO) by significant global entities (SGEs). The PED follows numerous recently enacted and proposed future Australian tax laws including the Multinational Anti-Avoidance Law (MAAL), current and to-be-expanded transfer pricing laws, Country-by-Country reporting (CbCR), General Purpose Financial Statement requirements (GPFS) and diverted profits tax (DPT), to name a few. We acknowledge media and EM speculation about risks of potential SGE non-compliance with initiatives such as CbCR and GPFS requirements.

We are particularly concerned that arising from the PED:

- vastly increased penalties might apply to very minor breaches
- there are risks of multiple penalty impositions at the higher penalty rates, that may cause excessive financial exposures in inappropriate circumstances
- major penalty exposures might occur for some companies that might not even be aware of their SGE status
- penalty multiplication and remission might be inappropriately used as a negotiating tool by ATO officers in their interactions with SGEs.

For example, a company which lodges any "approved form" one day late with the ATO, because of staffing issues, will (if it is not an SGE) will be exposed to a potential administrative penalty ranging from $180 to $900 (see EM para 1.10) but if it is an SGE the penalty will be 500 times that penalty.

There are also penalty multiplication risks: a company which lodges a document, say a GPFS disclosure or transfer pricing response to the ATO, using its best endeavours but which contains 5 minor errors might have a risk of 5 penalty impositions. The total penalties could result in potentially serious adverse financial exposures and consequences for SGEs. The multiple penalty risks will be significant for all SGEs but even more severe for Australian subsidiaries with relatively low individual resources (and/or for their directors).

The ATO penalty-remission guidelines have not been updated to deal with the new and upcoming obligations. These proposals also raise the prospect of a floodgate of penalty remission applications

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by SGEs which will cause major disruption and burdens for both the ATO and also small Australian companies that might be SGEs.

We set out below, more details on the above issues and also other key policy, law design and administration concerns with the PED and EM. Our concerns are principally directed at the proposed increased "failure to lodge penalties" (where the base penalty amount is to be multiplied by 500 for SGEs instead of the existing multiplication by 5, for large entities), unless otherwise stated.

1. The SGE annual test time makes this a problematical definition, and the test time for penalty purposes should be changed

The current definition of SGE means a company's status can change annually. Further, many companies have not turned their mind to the issue as yet. In addition, the proposed test time for SGEs for penalty purposes (at the time of each proposed failure to lodge on time) is problematical.

a. The concept of an SGE – broadly, a company which is a member of a group with global turnover of broadly more than AUD 1 billion per annum - first appeared in the context of the MAAL effective from 1 January 2016, and applied to a very small taxpayer population.

b. Many smaller Australian based subsidiaries of foreign-owned groups may not know if they are SGEs. As the SGE threshold involves global turnover of AUD 1 billion, a group can be a non-SGE one year, become an SGE in the next year, then cease being an SGE in the third year. So there is an annual SGE status volatility and testing requirement of which the company might not even be fully aware. For example a small Australian company with a $25 million turnover which is owned by a foreign group might be an SGE depending on the AUD currency exchange rates in one year and not be an SGE in the following year.

   The PED has no de minimis carveout for small SGEs. However the proposed exposure draft for the proposed DPT (which will apply to SGEs) provides a "de minimis" carveout for SGE entities with Australian turnover less than $25 million, subject to an integrity rule.

   We submit that the SGE definition should be adjusted when applied to the penalty proposals. The PED should have a de minimis exclusion for SGEs with turnover of under $25 million per annum, ideally to harmonise with the DPT rules. There may even be scope for that SGE de minimis adjustment definition to be applied to the MAAL rules.

c. The time at which SGE status is determined under the PED for penalty purposes may not align with an entity's SGE status testing for its other income tax purposes: the PED states that entities will be required to determine their SGE status on each day they are required to lodge any approved form with the ATO ("**lodgment requirement date**") - see EM paragraph 1.22- for penalty purposes, and not the prior year of income to which the lodgment relates. If the entity actually was not an SGE for the relevant income year in respect of which an approved form was due but is an SGE at the lodgment requirement date, it is exposed to sharply increased penalties.

   We submit that Treasury should adjust the penalty SGE test time to align to the year of income to which the disclosure relates. At minimum the ATO should develop guidance when the law is introduced to identify this express category of penalty remission for purposes of its guidance.

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2. Target the penalty multiplication for SGE existing tax lodgment obligations at deliberate taxpayer actions

The proposed increased penalties will apply to numerous existing tax lodgment obligations (e.g. tax return, notice, statement or other approved form) to be lodged with the ATO.

Paragraph 1.2 of the EM claims that "existing penalties may not be an effective deterrent for non-compliance by these types of large entities given the significant financial resources that large companies have at their disposal". This statement does not provide evidence of a current compliance problem. Furthermore, it is unclear whether the drafter of this statement has properly considered the potential for multiple entities to apply in many cases, under the existing penalty provisions.

The very significant proposed increased penalties need to be better targeted to deliberate taxpayer actions in relation to lodgments and disclosures that are important to the ATO, and not automatically apply to minor or trivial breaches (to minimize compliance burdens for both taxpayers and also the ATO).

This better targeting could be achieved by recognizing additional processes and having additional threshold tests, in the SGE penalty rules. For example, there would be merit in having an additional threshold test that the SGE entity has failed to comply with an ATO formal notice of breach sent to the taxpayer. Such ATO notification processes already exist for some ATO approved forms (e.g. late lodgment of tax returns), but not all ATO approved forms. The significant SGE penalties should only automatically apply where the SGE fails to comply with the formal ATO notice, but there should still be an ability to request a remission of penalties in appropriate circumstances (factors outside the control of the SGE).

We submit that the proposed increased penalties for existing tax lodgment obligations should not proceed in their current form. The penalty provisions should:

a) be targeted at deliberate taxpayer actions, with statutory language to confirm that the 500 times multiplication is not intended for minor inadvertent breaches, delays or failures
b) recognise additional processes and having additional threshold tests, in the SGE penalty rules, so that SGE penalty exposures only automatically apply where there has been a breach of a requirement specifically notified to the SGE for matters important to the ATO. For example an ATO warning notice of impending penalty could be built into ATO processes for the most relevant risks
c) have express reference to the ATO capacity to remit penalties including for reason of small Australian companies having lack of awareness of their SGE status in a year
d) be accompanied by an ATO commitment to update its *Administration of the penalty for failure to lodge* guidance in PSLA 2011/19 before 1 July 2017.

3. Target increased penalties for SGE deliberate non-compliance with CbCR and GPFS requirements

We acknowledge concerns from some quarters that some SGEs will not comply with new tax lodgment and disclosure obligations directed specifically at SGEs, including the new CbCR measures and the new GPFS requirement.

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We submit that, if the concern is about specific new tax lodgment obligations for SGEs (e.g. CbCR and GPFS) then the law should be designed to target increased penalties to deliberate non-compliance with those specified obligations. Further, as noted above, they should:

a) be targeted at deliberate taxpayer actions, with statutory language to confirm that the 500 times multiplication is not intended for inadvertent breaches or delays or failures
b) have express reference to the ATO capacity to remit penalties including for reason of lack of taxpayer awareness of their SGE status in a year
c) be accompanied by an ATO commitment to update PS/LA 2011/19 before 1 July 2017.

4. Transitional relief for failure to lodge penalties in relation to the GPFS requirement

The proposed amendments are intended to apply from the later of 1 July 2017 or the date that the amendment Bill receives Royal Assent. EY welcomes the potential deferral of the start date if the enactment of this legislation is delayed.

However, EY submits there is a need for potential additional transitional relief that should be considered, in particular for the new GPFS requirement, which applies to income years commencing on or after 1 July 2016.

The recently enacted GPFS requirement is currently presenting various implementation challenges to SGEs, tax and accounting professionals, software providers, the ATO and other stakeholders, which may not all be suitably resolved in time, in relation to GPFS reporting that may be required by 30 June balancers on or after 1 July 2017.

The ATO is reviewing submissions in response to its plan for proposed guidance on the "Provision of general purpose financial statements by significant global entities" following the ATO compendium of issues from submissions (GPFS issues compendium) of 30 November 2016. The GPFS issues compendium extends to 15 pages and 31 separate issues, which confirms the complexity and uncertainty associated with the GPFS measure.

EY strongly encourages Treasury to consider providing transitional relief, until 1 July 2018, in relation to the application of the increased failure to lodge penalties to the GPFS requirement. That is, the Bill can proceed with the amendment to treat a GPFS as an approved form, but maintain the existing penalty levels for "failure to lodge breaches" until 1 July 2018. At minimum there should be clear language, ideally in the statute or EM that there will be teething troubles in relation to the first GPFS lodgments in relation to the issues mentioned in the GPFS issues compendium and the penalty multiplication risk should be mitigated here.

5. Update EM for increase in penalties under 2016-17 MYEFO announcement (range is $105,000-$525,000 not $90,000-$450,000)

The 2016-17 Mid-Year Economic and Fiscal Outlook (MYEFO) released on 19 December 2016 noted that the Government proposes to increase the value of the Commonwealth penalty unit from $180 to $210, with effect from 1 July 2017. If the MYEFO proposal is implemented this means that there will be an immediate large rise in the failure to lodge penalties applicable to SGEs from 1 July 2017.

We submit the EM to the final Bill should be updated to reflect the higher proposed penalty rates under the 2016-17 MYEFO announcement.

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6. Need for updated ATO guidance on penalty imposition and remission

As mentioned earlier we are very concerned about the risk of excessive inequitable penalty exposures, for potential minor breaches, under the proposals contained in the PED. This risk is magnified by the potential for multiple penalties to apply from a single course of conduct (either penalty unit based penalties or percentage based penalties).

We submit that the ATO should:

a) prepare a Law Companion Guide to the law when passed, that highlights the significance of SGE status and the need for corporate self-assessment of their SGE status or otherwise
b) adjust income tax returns and instructions to require companies to self-assess whether they are SGEs at the time that tax returns are prepared and lodged
c) in addition to the abovementioned update of relevant penalty remission guidance and processes

to ensure that the ATO's proposed administration of these very harsh proposed penalties for SGEs will in practice produce more appropriate outcomes on these issues.

* * * *

We are prepared to consult with Treasury and other stakeholders throughout January and 2017 to improve the Exposure Draft that supports certainty in Australia's tax system.

If you would like to discuss these issues outlined in this submission, or any other aspects of the proposed Exposure Draft, please contact in the first instance Alf Capito on (02) 8295 6473, Sue Williamson on (03) 9288 8917, Tony Stolarek on (03) 8650 7654 or Richard Czerwik on (03) 9288 8408.

Yours sincerely