COMMONWEALTH OF AUSTRALIA

Proof Committee Hansard

SENATE

ECONOMICS REFERENCES COMMITTEE

Corporate tax avoidance

(Public)

WEDNESDAY, 8 APRIL 2015

SYDNEY

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SENATE

ECONOMICS REFERENCES COMMITTEE

Wednesday, 8 April 2015

Members in attendance: Senators Canavan, Dastyari, Edwards, Ketter, Milne, Xenophon.

Terms of Reference for the Inquiry:

To inquire into and report on:

Tax avoidance and aggressive minimisation by corporations registered in Australia and multinational corporations operating in Australia, with specific reference to:

a. the adequacy of Australia's current laws;

b. any need for greater transparency to deter tax avoidance and provide assurance that all companies are complying fully with Australia's tax laws;

c. the broader economic impacts of this behaviour, beyond the direct effect on government revenue;

d. the opportunities to collaborate internationally and/or act unilaterally to address the problem;

e. the performance and capability of the Australian Taxation Office (ATO) to investigate and launch litigation, in the wake of drastic budget cuts to staffing numbers;

f. the role and performance of the Australian Securities and Investments Commission in working with corporations and supporting the ATO to protect public revenue;

g. any relevant recommendations or issues arising from the Government's White Paper process on the 'Reform of Australia's Tax System'; and

h. any other related matters.

WITNESSES

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HASTINGS, Ms Debbie, First Assistant Commissioner, Review and Dispute Resolution, Australian Taxation Office 19

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VANN, Professor Richard John, Private capacity 9

WARD, Mr Jason, Research Coordinator, United Voice 1

CARLSON, Mr Anthony, Member, New South Wales Branch, United Voice

DOYLE, Ms Kay, Member, New South Wales Branch, United Voice

O'BYRNE, Mr David, National Secretary, United Voice

WARD, Mr Jason, Research Coordinator, United Voice

Committee met at 08:48

CHAIR (Senator Dastyari): I declare open this hearing of the inquiry by the Senate Economics References Committee into corporate tax avoidance and aggressive minimisation by Australian companies and multinationals operating in Australia. The Senate referred this inquiry to the committee on 2 October 2014 for report by the first sitting day in June 2015. The committee has received 91 submissions so far, which are available on the committee's website. Two submissions have been received as confidential. These are public proceedings, although the committee may determine or agree to a request that evidence be heard in camera. I remind all witnesses that in giving evidence to the committee they are protected by parliamentary privilege. It is unlawful for anyone to threaten or disadvantage a witness on account of evidence given to a committee, and such action may be treated by the Senate as a contempt. It is also a contempt to give false or misleading evidence to a committee. If a witness objects to answering a question, the witness should state the ground upon which the objection is taken and the committee will determine whether it will insist on an answer, having regard to the ground which is claimed. If a committee determines to insist on an answer a witness may request the answer be given in camera. Such a request may also be made at any other time. I welcome representatives of United Voice and the Tax Justice Network. Do you have any comments to make on the capacity in which you appear?

Mr O'Byrne: I have with me two United Voice members from our New South Wales Branch: Anthony Carlson and Kay Doyle. Anthony is a hospitality worker and Kay is the owner and director of two childcare centres.

CHAIR: I invite you to make an opening statement.

Mr O'Byrne: Thank you for the opportunity to appear today at this hearing on corporate tax avoidance and the impact it has on our budget and public services. United Voice has been very supportive of an inquiry into these important issues, and we appreciate the opportunity to speak with committee members and discuss further some of the recommendations we have made in our submission.

United Voice is a union of over 120,000 workers across a range of industries. It represents, amongst others, early childhood educators, cleaners, aged-care workers, ambulance workers, cleaners working in the hospitality industry and health-care workers. United Voice members work in publicly funded sectors and rely on public services. That is why tax matters to them. They rely on government to provide access to quality public services, to ensure a secure retirement and to do what is necessary to safeguard a fair and equitable society.

United Voice started its work in corporate tax avoidance after having conversations with our members about the most important issues they face today. Our Real Voices project surveyed 26,000 members, asking about the biggest issues in their lives and their ideas for change. Time and time again we heard how our members were worried about cuts to essential public services such as health, education and pensions. There was a real concern amongst members that ordinary Australians and small businesses will end up paying more and getting less in return as services are cut and that, at the same time, those at the top are failing to pay their fair share.

Our members, like the majority of Australians, are happy to contribute their fair share in taxes to fund the quality services and infrastructure will rely on. They just want to know that everyone else is paying their fair share too. When corporations aggressively minimise their tax obligations we all pay the consequences through reduced services, outdated and failing infrastructure and increasing inequality. The tax-aggressive behaviour of some Australian multinationals should be of considerable concern for government and civil society alike. The need for Australia to reduce its debt and balance its budget has repeatedly been cited as the reason for cuts in services, which have a disproportionate impact on low- and middle-income Australians. Yet within the ensuing debate, little attention has been given to the issue of revenue raising. At the same time, the issues we face in Australia are emblematic of a much larger systemic problem of global corporate tax avoidance. Companies are able to utilise a network of subsidiaries registered in secrecy jurisdictions to structure their internal company finances in ways designed to significantly reduce their overall tax obligations. Some of the companies that are most vocal about maintaining the status quo have been the worst tax offenders. Chevron and GE, two of the leaders of the Corporate Tax Association, have engaged in aggressive tax minimisation strategies for many years.

United Voice's submission to this inquiry lists key measures that need to be taken to ensure that corporations—national and international—become lifters, not leaners, in our economy. Some of these measures include:

compulsory country-by-country reporting for all Australian listed companies; disclosure of all subsidiaries, including an explanation of the purpose of those located in tax havens; disclosure of intergroup loans by all Australian companies, not just multinationals; and also, and importantly, ensuring that the Australian Taxation Office is adequately funded and staffed to do its work. Increased transparency and stronger enforcement mechanisms are important first steps in combating corporate tax avoidance. Nearly one-third of the ASX200 companies have an effective tax rate of 10 per cent or less. That contributes to a loss of up to $8.4 billion in revenue, and that is just the Australian top companies. A report last week showed that the top 900 companies pay an effective tax rate of around 19 per cent, on average, less than the average Australian worker. That is just not good enough. We are calling for the government to do the right thing and adopt a bipartisan approach to ensuring corporate tax avoidance is stamped out. Thank you, again. I will now turn to Anthony and Kay to tell the committee why this is an issue that is important to them and thousand decision will it is so for so you are not shown are really the last longer s like them.

Ms Doyle: Thank you to the committee for inviting me here today. It is encouraging that the voices of Australian workers and small business owners are being heard alongside big businesses.

I am a United Voice member and a small business owner. I am the approved provider of two childcare centres and have worked in the early childhood education and care sector for over 45 years. My centres provide an important service for children, families, the community and the economy. They educate and care for young children and they allow parents—mothers—to participate in the workforce and to make a contribution to the country's economy. Educators in the early childhood sector play a trusted and vital role in our communities. Every day we are shaping the minds of the next generation of Australians and doing it all with a smile.

I have seen how the funding of education and care of young children has been compromised by inadequate government funding. If big business paid its fair share of taxes, the government's revenue would be in a much healthier position. Young children should be a national priority. There are over one million children in child care in Australia. Their future depends on the quality of education and care our nation provides for them. Low-income workers are paying a lot of tax without having any way of escaping. Then the government makes cuts to essential services that I rely on and that parents I speak to every day rely on. These businesses can afford to pay their fair share and yet they do everything to avoid it. It seems unfair to me.

Mr Carlson: I would like to thank the committee for having me here today and for holding this inquiry into an issue that is important to all Australians. I have been a United Voice member for approximately 10 years. I have worked in hospitality, leisure and tourism for over 30 years. I am here today so that I can tell the committee that ordinary people like me pay our taxes and yet we are expected to bear the brunt of these budget cuts, which I consider to be fairly vicious.

Taxation is the price of a civilised society. It buys us services. It gives us health, education, low-cost housing and security. When big business does not pay the tax they owe to the government, we all suffer; we miss out on the essential public services. I have a feeling that this is going to be even worse for the next generation. I have two children and two grandchildren. I am concerned about what their life is going to be like when they come to the age of adulthood.

The government talks about a 'budget emergency' but maybe it should start by looking at the behaviour of the big corporations which minimise the tax they pay until it is virtually zero, rather than making life harder for those who can least afford it. I cannot minimise my tax. I do not get that opportunity.

When I read this report I was shocked. I had heard about companies dodging their taxes but I had no idea how bad the problem was. It made me realise that the government could be doing more. And I am upset that the government has not been doing more. I have come here today to ask this committee to make sure all members of our society pay their fair share. I would appreciate that.

CHAIR: I know there are a fair few questions from different senators. I remind senators that we are going to try and stick to a very tight time frame, especially considering there is a particular interest in a lot of questions this afternoon. So to try and get through everyone we are going to try and stay religiously to time. Senator Ketter?

Senator KETTER: Thank you. Thank you, Mr O'Byrne, for your submission and for the work that your union is doing in this area. You have talked in your submission about a number of techniques used by multinationals to minimise tax. Firstly, I want to ask you about this concept of intraparty loans, and I would like you to elaborate on how multinationals use those loans to reduce their tax bills.

Mr O'Byrne: I think most people would be shocked to realise that 60 per cent of global commerce now occurs within companies. There is a whole range of pricing mechanisms and strategies deployed to shift debt and equity around where it is obviously beneficial in terms of their tax treatment, pushing their debt into those

countries which have a taxation regime which allows for deductions and allows for, I suppose, a different level of treatment than in other jurisdictions and moving profit to those countries. That allows them to repatriate, in some sense, but also to use their structures in low-tax regimes or tax havens to hide their profits globally. Our head of research, Jason Ward, has done particular work on this, and I might ask him to add to that answer.

Mr Ward: I think a very good current example of this is the ATO's lawsuits in the Federal Court against Chevron for essentially creating a US tax haven in Delaware, for the specific purpose of borrowing money and then on-lending that. The numbers may not be exactly right, but I think they were borrowing at around one to two per cent and then on-lending to the Australian subsidiary at around nine or 10 per cent and basically using those interest payments to reduce the tax liability in Australia.

Senator KETTER: As my time is short, I am going to move on to the next issue, which is an important vehicle that you have touched on—the tax secrecy jurisdictions and tax havens. Can you give us some common examples of tax havens?

Mr Ward: The report we published late last year lists the disclosed subsidiaries of companies, the subsidiaries located in key tax havens. I ask: what business operations do many of these companies have in the Cayman Islands, in Bermuda, in the British Virgin Islands? Are there legitimate business operations going on there? Perhaps, but I think it is probably unlikely. Obviously, Singapore is considered to be a tax haven. We have seen some recent articles in the media in the last few days about the use of Singapore as a tax haven. Clearly, there are legitimate reasons to have business operations in Singapore, but there is also a potential abuse of the system there.

Mr O'Byrne: We have also seen a fair bit of use of these marketing hubs—it is called the Singapore Sling—where companies are setting up significant operations relative to the activities in certain countries because they have lower treatment of profit and tax. Some people call these tax havens—that is a nice way to put it. It is actually a secrecy jurisdiction. What we are calling for is that, if you do have operations in those countries, you should disclose exactly what they are there for, how they are structured and what obligations you are meeting, not only in the country of origin of the profit, but also how that money is repatriated to those countries. The concern is that a whole lot of organisations set up companies in these jurisdictions that no-one knows anything about, and that is the level of the lack of transparency that we are seeing. Everyone knows that they are engaging in this sort of activity. We want to call it out. When you see significant corporate leaders in Australia—Westacott, Smith, others—saying, 'Actually, we pay our taxes here in Australia,' this is the next issue that corporate Australia has to confront in terms of their ethical behaviour.

Senator KETTER: Mr O'Byrne, I am interested in your opinion as to the effect that the staff cuts at the ATO have had on our capacity to address the issue of tax minimisation.

Mr O'Byrne: The effectiveness of any law that is in place is only to the point where it can be enforced. If the ATO, with thousands of jobs being stripped away, have been hamstrung in their abilities and their resources to go after tax avoiders, regardless of where they are—if they do not have the resources to pursue the case—then it is not going to happen; it is not going to occur. People will not be brought to justice. When you see the big four, arguably it is an arms race. At the moment, we believe that the ATO does not have adequate resources compared to large organisations, large multinationals, who can deploy millions of dollars in resources to ensure that the trail of money, the structures that they have, are very difficult to be called to account. The big four are doing a fantastic job for their customers—there is no doubt about that—but they are actually doing a disservice to the Australian community and the Australian Taxation Office. That is despite some recent dedication of resources in a particular area. That was welcome, but when you lose 3,000 or 4,000 members of staff and you replace them with 40 or 50 to go after a certain area, it is still underfunded and it is still under-resourced.

Senator CANAVAN: Mr O'Byrne, thank you for your submission. I think we all accept that this is a large problem and almost all governments around the world are trying to tackle it at the moment. Thank you for your suggestions and recommendations. I go in particular to your recommendations for more transparency and disclosure of subsidiaries. What additional powers would this provide the tax office? I would have thought that, if they feel there is a problem, they would have powers under their act. They have quite substantial powers right now. They would have powers to request this information. Am I wrong in that supposition? We have not had them before the committee yet.

Mr O'Byrne: Given the current reporting requirements, given the current legal framework and given the clear information that is out in the public domain around the strategies that have been applied and deployed by these large multinationals, clearly there is a deficiency. I am not a legal expert; I do not understand and do not pretend to be across the full legal framework of the ATO. That would be more a question for them. In the public domain you have clear information and evidence that leads to significant tax minimisation and aggressive tax behaviours. Not only Australia but sections of corporate Australia are calling out, as are governments across the world. Even a

conservative government in the UK is taking steps to strengthen their laws. As we know, when you have a set of laws, there is a response by corporate Australia. There is a response by those people who fall within that domain and they seek further advice from consulting companies and others to ensure that they can change their strategies to minimise their tax. So clearly the laws are deficient and clearly there needs to be some strengthening and some greater levels of reporting to allow the community to see exactly what is going on.

Senator CANAVAN: A couple of years ago we did strengthen our laws with regard to capitalisation and transfer pricing as well. Some of those were implemented by the former Labor government. Have you had a look? It has only been a couple of years, of course, since their introduction. A lot of the issues that you raised, Mr Ward, spoke about transfer pricing around debt obligations. You do not see those has being sufficient? They have given more powers or an expanded footprint for the ATO in these areas. How do you assess them as working? Have they been inadequate in your view?

Mr O'Byrne: The previous government took steps forward in this area. I understand there has been a level of debate with the current government. We are concerned about some of the watering down of those requirements, in terms of blanket reporting as opposed to individual case-by-case management of some of these issues. This is an evolving area. We have seen companies over the last decade create very sophisticated strategies to avoid their obligations and it is a constant challenge for governments to respond. It is not a point-in-time issue. This is something that evolves. We need to create an Australian legal framework which responds to those changing environments.

Senator CANAVAN: You mentioned the $8.4 billion figure from the Tax Justice Network report. In your submission you mention it in passing. It has come under some serious criticism. It came up at Senate estimates last time or the time before last. You might know that Mr Heferen is a Treasury official of substantial experience with both governments. I asked him whether he saw anything in the Tax Justice Network report that would indicate an erosion of the tax base and Mr Heferen responded:

The Tax Justice Network deals with something completely different. It is not even in that debate or discussion. It is fundamentally a misunderstanding of what taxable income in Australia ought to be about. On page 8 of the report in the findings it states, 'The research presented here suggests that the tax planning activities of the ASX200 allow Australia's largest publicly listed companies to avoid up to an estimated $8.4 billion in corporate tax annually.' That is patently false.

Mr Heferen is quite an expert in this field. They were pretty strong words, I would say, from a bureaucrat. How unusual that they would be so vivid in their language. How do you respond to those criticisms that there was confusion about taxable and accounting income in that report?

Mr O'Byrne: I am not suggesting that this public servant is shooting the messenger but when you throw something out into the public domain based on publicly available information as best as you can in terms of determining an effective tax rate, particularly in an area where there are significant consequences for a change in the law, there is no doubt that our report came under attack from certain sections. I will say two things. One, it shows that, on the basis of publicly available information, if there is this level of disagreement about the stats surely that indicates that there is a problem. Surely that indicates that there is a lack of public information out there that is easily accessible and easily explained to people to justify the actions of certain corporations. In the recent heavily redacted report that was put out in the public domain via a freedom of information request from the Uniting Church, the ATO themselves, in terms of how they were doing their calculations, used the very same methodology that we used. So, looking at the most recent work of the ATO, they used very similar methodology so we do not think the criticism is fair. We will always sit down and talk through greater detail. In fact, we were surprised by the amount of corporations that we named in that report who contacted us and wanted to sit down and talk with us and talk through how we treated their documents. There was very constructive engagement with corporate Australia.

Senator CANAVAN: Can I just interrupt you there, Mr O'Byrne. You said the ATO used a similar methodology, but did they conclude that Australia's largest publicly listed companies avoid up to an estimated $8.4 billion? You have used the word 'avoid' there which has certain connotations in this debate. I think that is what Mr Heferen was pointing to as patently false—that you could not draw that conclusion from the methodology you used. That conclusion was drawn. Was that conclusion false in your view?

Mr O'Byrne: We contest that. I think that is a matter that we would contest. We stand behind our report. It has been shown more recently that the ATO has used a very similar methodology to the one we used so, whilst one public servant has given their opinion, we have received significant feedback from not only the Public Service but corporate Australia that confirms in broad terms the thrust of our report.

Senator EDWARDS: He is the most senior revenue public servant in the country in that field.

Mr O'Byrne: And that is a question for the tax officer this afternoon.

CHAIR: We have him tomorrow. Mr Heferen is speaking to us in Canberra tomorrow.

Mr O'Byrne: I think that is a question for the tax office.

Unidentified speaker: He is a reasonable man.

Mr O'Byrne: I am not saying he is unreasonable.

Senator CANAVAN: I have more questions but I am happy to cede the call.

Mr O'Byrne: If I could just make one more point on that. The fact that the methodology we used has been used by the ATO in an internal document that is in the public domain now I think shows that this is a contested space, and we stand by our report.

Senator MILNE: Just on that before I go on to my line of questioning, is the issue here the word 'avoid' implies an illegal activity, if you like, whereas 'minimise' is legal? Is the tax office's issue not that that amount of money is not paid in Australia but that it is a question of the legality of whether it is tax avoided or tax minimised? Is the issue that rather than the amount of money that is not being paid in Australia?

Mr O'Byrne: I think that is a very good point, Senator. Clearly that debate will continue to range around the moral obligations of corporations to the countries in which they derive their profits.

Senator MILNE: I do not think there is necessarily the contesting of the amount of money concerned that is withheld from Australia. Just as to the moral obligation of corporations, one would have to be a little naive to think that corporations thought of themselves as behaving in an ethical or moral manner and that is why we come back to requiring it in the law. I want to come to that.

The particular line of questioning I have got is around the role of KPMG, Deloitte, PricewaterhouseCoopers and Ernst & Young—the big four. They were called out in a UK House of Lords' inquiry for dereliction of duty for ticking off the audits of many of the corporations that collapsed during the global financial crisis. Would you now say that we have a revolving door between big business, the big four firms, the tax office, the Treasury and government ministers whereby now there is negotiation rather than actual straight laws and obligations that need to be met?

How serious is this conflict of interest in the context of corporations avoiding paying the tax that they should pay in Australia, if the law required them to?

Mr O'Byrne: I think it is of significant concern that there is this level of familiarity between the institutions and between the players you have outlined in your question. It is of great concern to us. We, over 18 months ago, were approached by KPMG to engage with other members of civil society in a discussion around the tax base in Australia and dealing with some elements of corporate tax avoidance. Late last year there was the report out of Luxembourg that PwC had deployed some significant tax minimisation strategies for that company globally. We then raised that issue with PwC about that. We removed ourselves from that process. They were of the view that, 'We are a different arm of PwC, and it has nothing to do with us', effectively. We did not accept that. We thought that was of great concern to us, and, on a matter of principle, we should no longer be engaging in that kind of discussion. We chose to maintain our independent status in terms of our views on corporate tax. I think the disinfectant of light will be a very good outcome of this Senate committee, if we are able to shine a light on what is actually happening in those discussions. There needs to be a greater level of transparency. There needs to be a greater level of awareness of those kinds of discussions, so that the Australian public can make their own minds up about the veracity of the intent of the players at the table. We are very concerned about that.

Senator MILNE: Last year there was a proposal that the tax office use the big four accounting firms rather than their own people. They sacked a whole lot of people from the tax office, and then there was a proposal to use the big four to advise the tax office on how to go about taking on the issue of tax avoidance and tax minimisation. At the very same time, these firms are facilitating some of the most significant and huge tax avoidance schemes around the world, including in Luxembourg. Is that still the case? Are these big four consulting to the tax office to provide advice on the various schemes that they themselves have devised and are making a fortune running out to these corporations?

Senator EDWARDS: On a point of clarification: are you asserting that that is taking place here in Australia?

Senator MILNE: That is what I am asking.

Senator EDWARDS: I will be very interested in any examples of that.

CHAIR: In answering that, Mr O'Byrne, I would note that some of these are questions that we will put to the companies themselves and the tax office. Answer the question to whatever capacity you can. I think you are bordering on being asked for an opinion, but there is a question there.

Senator MILNE: I am asking: do you know?

Senator EDWARDS: I am interested to know if you know about any specific cases too.

Mr O'Byrne: I think that this is of great concern: the ideological approach that a whole range of government decision making should be contracted out and government service delivery should be contracted out to the private sector. I think tax, unfortunately, is one of those things which seems to be occurring. We are very concerned that, not only is there a relationship between the ATO and the contracting out of work to the big four, you have a number of recently employed public servants who are now working with the big four. I think the question around the relationship between the ATO and the big four consulting firms is of real concern. I will hand over to Jason, head of our research, who will give a specific example.

Mr Ward: I think that is the case that is going on. I am not sure if it has been implemented, but the ECAP proposal does exactly that. It basically farms out the auditing function of the ATO to the big four firms who then, as you correctly pointed out, give them advice on how to avoid paying taxes. That is a huge problem and a major conflict of interest. Likewise, the revolving door is a huge issue that needs to be addressed.

Senator EDWARDS: Are you talking about deliberate, illegal acts with these companies, or are you talking about tax minimisation? We have to watch our language and be very clear. Is your interpretation of tax avoidance an illegal activity, or should you be saying tax minimisation? Are you suggesting illegal activity?

CHAIR: Let us be clear about what the distinctions are in this. Tax avoidance is questionably moral behaviour. It is legal. Tax evasion is illegal behaviour. I think they are the two terms.

Senator XENOPHON: Tax avoidance is different from tax minimisation and from tax evasion.

Senator MILNE: Tax evasion is illegal.

Senator EDWARDS: We have all got a grasp now.

CHAIR: Is that right, Senator Canavan?

Senator CANAVAN: I have just googled it and it is right.

Mr O'Byrne: I think there are two issues. One is the moral question, which I think is the key debate in the Australian community. There is no doubt about that, and the ATO are currently taking action against a whole range of companies, multinationals and Australian based companies that they believed, allegedly, are undertaking tax evasion. Tax avoidance is a moral question. The question from Senator Milne was about the appropriateness of the ATO engaging the big four to provide advice around appropriate tax law. We believe it is inappropriate because the fundamental role of the big four consulting firms for their customers and for their clients is to provide tax advice and create tax regimes which benefit that company, which directly work against the interests, in our view, of the Australian community and of the ATO.

Senator MILNE: Given that we now have a situation where people who were made redundant from the Tax Office last year and who are expert in this field have now gone to work for the big four to advise them on what the thinking is in relation to their tax, is that a big issue for you?

Mr O'Byrne: We think it is crucial. They are not only being employed but also, in some respects, being engaged as consultants as well. So there is a whole range of conflict, we believe, and it is a real problem.

Senator MILNE: Just on that, do we need to extend the public disclosure legislation, the whistleblower legislation, in Australia to cover the private sector? We have quite good whistleblower laws for the public sector, but, from what I have read, and in your submission you say that, compared with other countries in the G20, Australia is particularly poor at providing whistleblower support and cover for people in the private sector. Given that these four companies, in particular, know exactly what is going on, would it not be a good idea to extend the whistleblower legislation to enable the public to be better informed?

Mr O'Byrne: We believe that is something that would be a strong recommendation from this committee.

Senator MILNE: That and the subsidiaries are something we could do immediately. We do not have to wait for anybody else.

Mr O'Byrne: No.

Senator MILNE: Country by country disclosure has already happened in the United Kingdom, is that correct?

Mr O'Byrne: Yes.

Senator MILNE: So there is no reason why we could not go with country by country disclosure now, naming those subsidiaries, and there is no reason why we could not extend the whistleblower legislation right now?

Mr O'Byrne: That is right. If there is nothing to hide there is no problem.

Senator XENOPHON: Further to Senator Milne's line of questioning in relation to the big four—and I am not suggesting that they are doing anything that is improper—do you consider that there is such an inherent conflict of interest that those big four accounting firms should not be giving advice the Tax Office? Do you think there ought to be a prohibition on a company that gives advice on tax minimisation also giving advice to the Tax Office?

Mr O'Byrne: I think the integrity of the independence of the ATO is crucial in this issue and any relationship with the big four consulting firms or any firm that is engaged with their clients on tax minimisation strategies is at conflict of interest, and that makes it very difficult for them to provide that frank and fearless advice.

Senator XENOPHON: So the ATO should not be getting advice from the big four, in your view.

Mr O'Byrne: They should not.

Senator XENOPHON: Further to Senator Milne's line of questioning about those senior tax officials that go and work with the private sector for the big four, to have a disincentive to that occurring, do you think there should be if not bans at least a moratorium so they simply cannot work for those sorts of firms for a period of, say, two years?

Mr O'Byrne: We have not come to a view on that. We think there is an issue with people moving seamlessly from the ATO to senior levels in consulting firms and, essentially, providing advice on the laws that they wrote. I think that causes conflict. Those individuals, obviously, have a right to make a living, and if they have been made redundant by a government we would not want them to end up on the scrap heap, but I think there is a real issue in that relationship.

Senator XENOPHON: In relation to your recommendation 7 with respect to whistleblower protection laws, in the United States a whistleblower gets a percentage or a portion of the damages or of tax recouped, in the event that malfeasance has been uncovered by a whistleblower. This has changed the culture and has got whistleblowers to come forward. Have you thought about the US-type approach, which acts as an incentive for whistleblowers to come forward?

Mr O'Byrne: No, we have not turned out mind to it. I would have some initial flags on that because, ultimately, the motivations of a whistleblower must be pure and must be to the issue. That may cause an unintended consequence, so I will take that on notice.

Senator XENOPHON: You know that many whistleblowers will not come forward because it will ruin their careers.

Mr O'Byrne: That is right. There may be other ways.

Senator XENOPHON: Could you take that on notice. Finally, do you have a view on the diverted profits tax announced by George Osborne, the UK Chancellor of the Exchequer, that it appears our Treasurer may well be emulating? Do you support that as an interim step in the absence of any multilateral agreement?

Mr O'Byrne: Any step which shines a light on that issue of moving profits from one jurisdiction to another with some penalty or with some tax paid is a step forward, but it should not be seen as an excuse for no other action. If that is the only action that is taken in relation to this issue, then they have failed.

Senator XENOPHON: Thank you.

Senator CANAVAN: On a related issue, you have called for more transparency for corporations; I understand that. The government at the moment has proposed greater transparency for union officials under the changes to the Fair Work (Registered Organisations) Act. It has been opposed by the Labor Party and therefore it failed in the Senate. What is your union's view on that?

CHAIR: That is a fair enough question. I will let it go, but can senators try to keep to the topic. There are enough topics to cover.

Senator CANAVAN: It is just that I know you had not made a submission to the Senate inquiry on that.

Mr O'Byrne: If you want to criticise unions, go for your life, Senator. Our view is that as a union we are very transparent. We act ethically. We act in the best interests of our members to make sure they get a decent job, that they have a decent life, that they are safe at work. The fundamental role of unions and our transparency is very clear. We believe that there is no—

Senator CANAVAN: You do not support the changes?

Mr O'Byrne: That is a matter for the Senate. It has not got through the Senate. We are very—

Senator CANAVAN: No, I was asking for your organisation's view.

Mr O'Byrne: No, of course we do not.

CHAIR: I know I have got a lot more questions and others have a lot more questions here, but with the consent of the table we may move on. I think there will be other opportunities, and I want to thank the union United Voice, who have been a strong supporter of this issue and who have really played an active role in it. I particularly want to thank Kay and Anthony for making the trip and for participating. Sometimes in these kinds of debates we lose sight of who we are actually talking about when we just talk to bureaucrats and CEOs, so thank you so much for making the journey. And thank you, David and Jason.

SADIQ, Professor Kerrie, Private capacity

TING, Associate Professor Antony Ka Fai, Private capacity

VANN, Professor Richard John, Private capacity

[09:29]

CHAIR: Professors, thank you so much for making yourselves available for our inquiry and for your submissions. I am well aware that each of you has had a very public role and has done lots of different op-eds, articles and pieces of media et cetera in this space. We really wanted to get you in fairly early in the process to talk through the broader issues and provide a bit of an explanation of some of the techniques and how this goes about. I now invite you each to make some brief opening remarks—and I stress 'brief' because there are plenty of specific questions, and a lot of what you may have prepared for your opening remarks will be covered by the questions senators have anyway.

Prof. Sadiq: Thank you for inviting me to address the Senate inquiry into corporate tax avoidance and aggressive tax planning. There are three interrelated terms of reference which I wish to briefly comment on. The first is the adequacy of Australia's current laws. We currently have a robust and sophisticated international tax regime and we have been proactive in amending laws when needed—for example, the transfer pricing regime and the thin capitalisation provisions. However, we cannot rest on our laurels and, even though the extent to which tax avoidance is currently affecting Australia's corporate tax base is unclear, reports indicate that aggressive tax planning is occurring. Corporate submissions to the inquiry all tended to say that company X complies with their tax obligations. The fact that base erosion and profit shifting is occurring, coupled with corporate compliance, means they are taking advantage of the current tax rules—and what many are doing is morally wrong. Unfortunately the current tax regime has no basis for addressing morally wrong behaviour. However, appropriate taxes are not being paid in the location of the economic activity. Tax rules need to focus on the underlying economic focus of transactions. To this end, the current laws are inadequate and out of date.

Secondly, we need greater transparency. Corporate tax transparency serves two functions: it informs governments and revenue authorities and it informs the public; the two can be mutually exclusive but do not need to be. In relation to informing revenue authorities a positive step is the automatic exchange of information in the common reporting standard, so Australia needs to continue its support of this measure. More importantly Australia should actively embrace the proposed standardise tax reporting approach under action 13 of the OECD's Base Erosion and Profit Shifting project, or BEPS project. Specifically, action 13 proposes enhanced reporting through a three tiered standardised approach for multinational entities requiring a master file, a local file and a country-by-country report. If OECD guidance is followed, relevant Australian taxpayers will be required to comply by 30 June 2018. Country-by-country reporting will allow revenue authorities to identify gaps where revenue is not being captured and assist them in identifying where their efforts should be directed. In relation to informing the public, the Commissioner of Taxation is now required to publish certain tax details of corporate taxpayers and this legislation should not be watered down. Informing the public builds trust in the tax system and helps to maintain the integrity of the tax base. There is a lack of confidence in the corporate tax system, and the public is calling for corporate social responsibility in relation to tax, not just compliance with tax obligations. Unfortunately very few corporations view tax as an economic contribution to public finances.

Finally, I will speak about opportunities to collaborate internationally and/or act unilaterally to address the problem. The fundamental problem of BEPS can be addressed in two ways: we can fix or amend the laws that allow for aggressive tax planning to take place or we can put in place more robust anti-avoidance laws such as the UK diverted profits tax—or the Google tax. Personally, I believe we should strive to fix the current system, particularly the transfer pricing regime with its flawed arms-length requirement and separate entity approach. This could require an incremental approach, which I believe we are potentially seeing, or a fundamental change to a new system such as unitary taxation with former reapportionment, which is not on the OECD agenda.

The OECD BEPS project is, however, designed to address deficiencies in the current international tax system. The BEPS project is focused on the proper design of the corporate tax system, and its recommendations will be finalised this year. The work of the OECD BEPS project will hopefully give countries the tools they need to ensure that profits are taxed where the economic activities generating the profits are performed and where value is created. To this end, Australia must collaborate internationally and should not act hastily or unilaterally. However, the OECD and the G20 do not make the laws. As such, it will be a case of sovereign nations adopting the recommendations out of the OECD BEPS project and countries like Australia entering into a multilateral convention, altering tax treaties or enacting domestic legislation. This is where Australia must be proactive in adopting OECD BEPS recommendations and also has the opportunity to show leadership within the region.

Prof. Vann: Thank you for the invitation to appear. I did not put in a submission, although I have put in a number of joint submissions to the OECD. I will say a few brief words about the OECD and G20 Base Erosion and Profit Shifting project. I will say a little bit about the structure of the Australian corporate tax system and its enforcement. In light of that, I will then touch on where I think the biggest risks are. The main message is that international corporate tax is not a simple issue and there are no simple single-country solutions; it requires coordinated action. I think the major tax issue for Australia is likely to be foreign corporates with local sales, not so much Australian corporates, for reasons I will explain.

The OECD project is essentially designed to shore up international corporate tax. It is important to understand that corporate tax is essentially a source based tax; it is taxing income where it is earned. It is not a tax levied by the residence country. We tend to forget in this debate that there is another level of tax on shareholders. Shareholders pay taxes on dividends and they pay capital gains tax on shares, and that is the tax that is collected by the residence country. So corporate tax is essentially a tax at source. That means if an Australian company has active business operations overseas the design of our system is quite deliberately that they do not pay Australian tax on that income. The other country collects the tax on that income. It is the Australian shareholders who pay tax on that income when it is distributed or when they sell their shares.

The BEPS project is trying to focus just at the corporate tax level and it is dealing with both systemic issues and design issues in the law. The systemic issues are pretty obvious: the economy has changed; the digital economy has made a big difference to the world. We are seeing an emergence of harmful tax practices not by tax havens but by the UK, the Netherlands, Luxembourg, Switzerland and many other countries who previously did not engage in these kinds of activities. They are passing laws deliberately to attract that income into their country. They are not attracting the activity, just the income—which is a concern. Finally, there is tax competition. Countries do compete for real investment, and that is something you have got to take into account in looking at this issue.

So the design issues are simply defects in the current rules—and Kerrie has already mentioned some of these. This includes transfer pricing rules, the treatment of interest deductions, the business tax threshold of the permanent establishment rule, and information enforcement and implementation. There are clear defects there. I have been writing about those my whole life and nothing much has changed in that time.

CHAIR: I assume it is not an issue for us to table this as a formal document.

Prof. Vann: Yes.

CHAIR: Thank you.

Prof. Vann: I think there are some risk at the moment for the BEPS project. I think it should succeed but we have to be careful. A risk is that it could fail. This is not the first time around. Last time, it started in 1998 and fell over in 2001 when President Bush was elected—he killed it. And the risk is that the US could kill this project at some point. At the moment, the US is gridlocked; it cannot do anything. It cannot change its laws to implement BEPS, nor can it change its laws to do things in the other direction. The project is trying to change rules that took 80 years to create in a two-year time frame. That is a very short time frame for technocrats but it is a long time frame for politicians—and the politicians are getting restive at the moment. In the UK, there is the diverted profits tax. I am somewhat cynical about that. I think it will collect very little revenue. If you look at how they calculate the income, they do not even know how they are going to calculate the income that they will try and collect from Google. There is an election in the UK in a month; that is why they have done it; it is not a sudden conversion on the road to Damascus.

CHAIR: That is a cynicism not shared by the table!

Prof. Vann: So it is a delicate line. Countries like Australia should be prodding the process forward. On the other hand, you do not want to break out because, if everyone goes in a different direction, we will end up with no international coordination.

I will now turn briefly to the Australian taxation system. The government has put out its tax discussion document *Reading Between the Lines*. In that document, they want to cut the corporate tax rate. We are collecting too much corporate tax, according to that document; it is not that we are not collecting enough. So the larger picture that the tax discussion document presents—which is not one that I agree with—is that our corporate tax rate is too high and it is a very inefficient tax that has bad effects for the Australian economy. But the main point I want to make about our current system is the imputation system. Again, reading between the lines in the tax discussion paper the Treasury wants to kill imputation. But it is the main cause of integrity in our system. By international standards we are not significantly affected by tax avoidance. Of the countries around the world, we are one of the countries affected the least—because the imputation system creates an incentive for our companies

to pay tax. If they want to pay franked dividends to shareholders, they have to pay Australian corporate tax—and our companies, believe me, want to pay fully franked dividends to their shareholders.

On the numbers from the tax discussion paper, we collect corporate tax of $65 billion—although that is rapidly declining because of the collapse in the price of natural resources. Of that, a huge amount is distributed. Only $24 billion is retained—$41 billion is distributed and that shows up as imputation credits mainly for Australian resident shareholders. If the companies do not pay the tax, the shareholders do not get the credits. At the moment, in my view, and it is reflected in both the discussion paper and the Henry review, whilst there is a natural floor on tax planning in Australia—I am not saying our companies do not tax plan, but they have a floor—if companies want to pay dividends of a certain amount to their shareholders and they want them to be fully franked, they have to pay tax up to that level before they can pay those dividends.

In light of that, it seems to me that the real risks for Australia are mainly the foreign corporates. Imputation does not impact them. The shareholders of those companies get no benefit out of imputation. So there is no natural floor on the tax planning in which they can engage. For our resident corporates with mainly local operations and customers—such as our banks and supermarkets—if you look at the Tax Justice Network report, they are paying taxes up near the corporate rate; their effective tax rate is up near the corporate rate. The effective tax rate will never equal the corporate rate—because of timing differences and a whole lot of differences between tax and accounting.

CHAIR: And because of deductions—government policy such as R&D grants.

Prof. Vann: Yes, R&D and a whole lot of other things. There are a whole lot of reasons—some accidental and some deliberate—why there is a difference between the two. So BEPS, for them, is not really an issue. There are resident corporates with significant foreign operations or foreign customers. BEPS is more of an issue with them; they can do some tax planning but, again, imputation puts a floor under the amount of tax planning they can do. If they move income out of Australia and do not pay tax on it, it has an effect, ultimately, on whether they can frank their dividends. More importantly, there is a risk for Australia, in particular, in the BEPS process.

If China starts taxing BHP, Rio and the rest we will not be taxing them. This process could shift tax revenue from Australia to China, so you do need to tread a little carefully when you think about how the process is going to operate. Just to iterate, for me the main concern when you analyse the structure of our system is, essentially, mainly foreign corporates who have little incentive to pay Australian tax.

Prof. Ting: Thank you very much for the invitation. I was especially happy when the chair asked me to cut short my opening statement. Professors Vann and Sadiq have already covered some of my points so I have already removed half of my statement—so it will only be two to three minutes.

CHAIR: We are friends already!

Prof. Ting: I have been researching corporate-taxation issues for the past 10 years. Before embarking on my academic career I was a tax partner of a major accounting firm, serving mainly multinational enterprises. I will jump to what Australia can do to protect its taxpayers. The ideal solution, as Professor Sadiq has pointed out, is international consensus. As transfer pricing is often at the core of most BEPS structures, the ideal solution is to fix the transfer-pricing rules on an international consensus basis. The OECD BEPS project has been trying to do that since 2013; however, the experience so far is not encouraging. Even modest proposals to reform the current transfer-pricing rules have been subject to fears and objections from business and tax professionals.

The fact that some countries do not seem to be wholeheartedly supporting that BEPS project worsens the situation. Research has revealed that the US has been knowingly facilitating these multinationals to avoid foreign taxes. Furthermore, the objective of this involvement in the BEPS project seems to be to undermine the project. If we accept this reality, what can Australia do? It may be worthwhile to consider second-best solutions. An example of a possible second-best solution is diverted profits tax, commonly known as the 'Google tax', which has been just introduced into the UK. Its design may not be perfect but at least it demonstrates what countries can do to protect their tax bases.

It is important to note that Australia should not adopt a carbon copy of the diverted profits tax. It is dangerous to transplant a foreign tax regime into our own tax system without proper consideration of local concerns and constraints. However, the tax does provide valuable experience on the design of an effective anti-BEPS rule in Australia.

In summary, the tax laws should be improved to provide a more powerful weapon for the ATO to challenge BEPS structures. A general anti-BEPS rule may be a second-best solution. It may not be the ideal solution but it may be a pragmatic and effective response to BEPS. Thank you. I will be pleased to answer your questions.

Senator MILNE: Thank you for your advice to the committee so far. There are a couple of issues I want to take up but I will start with the United States. Given what you have said, that they are basically there to frustrate the process rather than facilitate the process, we are having to look at what we are going to do in Australia, notwithstanding we continue the engagement through the G20 and OECD process. To go to the fundamentals of the issue here, as you said in your paper, the problem is a separate-entity doctrine that dictates each company be treated as a separate taxpayer. Given that, they can set up subsidiaries wherever they like, and then the transactions flow from that.

You said that we need to go back and look at tax law so that it looks at economic substance rather than legal form of a corporate group, and that should determine or dictate the income tax implications. How would you actually do that? What would you propose in the Australian context? We have had advice today, and it is certainly my view that we need to legislate to make sure that any company operating in Australia has to identify its subsidiaries. Then you get all the subsidiaries and you know what you are doing and you can then have the tax office pursue it. How would you make the shift to go to the change that you are suggesting?

Prof. Ting: Thank you for the question. Before I answer your question I want to clarify a point. I think Australia should continue to support the OECD's BEPS project. We will get something out of it. On the other hand, because of all the issues I just raised about the US attitude to its BEPS we should also think about what I call 'plan B'. What can we do in the industry? That is why I mentioned the diverted profits tax. In its design it basically says the tax office will have the power to tax a multinational's low-tax income sheltered in some tax havens if that structure lacks economic substance. Of course, the actual design will need much more effort to make it effective. Basically what this should achieve is to say, 'Okay, multinationals can set up any company anywhere and then create intergroup contracts.' At present the international tax rule says the starting point is 'we respect those contracts', even though it is integral. You may say it is not real but the law says we respect that and then try to come up with what we call an arms-length price for that contract. If we say that is not working effectively to do deal with BEPS, the alternative is to say: if those contracts are not commercially justifiable then the ATO should have more power to say, in a way, I will ignore those contracts and say in a real commercial world, without this kind of intergrouped relationship, what the group should do. A current tax case before the court is about interest rates charged by a US group on its Australian subsidiary. The group as a whole can borrow at two per cent. That is the reality. But the Australian subsidiary is paying interest to its own group companies at nine per cent. The ATO is fighting this case and has spent a lot of time and effort on it. The basic question is: it is an intergroup loan, which basically is not real in the sense that it is not paying to a third party, so why should we respect that as a genuine transaction for tax purposes? The enterprise doctrine basically will say that, in that case, because it is mainly tax driven, we should ignore that contract and say that if the group can borrow at two per cent then at most Australia should allow deduction only at two per cent.

Senator MILNE: Yes, but the issue here is: the Parliamentary Budget Office has given advice to say that if you do a diverted profits tax it is contravening tax treaties, and that is why you will not get away with it, because there will be all kinds of challenges around those treaties. Professor Vann was suggesting that there will be other problems associated with diverted profits tax. How do you respond to that?

Prof. Ting: That is why I said in my opening statement that we should not adopt a carbon copy of the diverted profits tax. It has this problem. The UK is very bold in this case. It is very technical, but in the design it very clearly says in certain circumstances I will override the treaty. I do not think Australia should go down that path, but there are other ways to design a similar Google tax that should achieve a similar objective without overriding the treaty. For example, in the tax law we have a general anti-avoidance rule—what we call part IVA. The law says that treaties cannot prevent the ATO from applying part IVA. Basically that means part IVA overrides treaties. It is allowed under the current law. Under the document disclosed by freedom of information by the previous witness, the internal ATO document said part IVA is not effective in dealing with BEPS structures because of the design of the current part IVA. One way to do it is to improve part IVA, incorporate some of the key elements of the profits tax into part IVA so we can use that to deal with BEPS structures.

Senator MILNE: That is a very good suggestion. Professor Vann, you say that the biggest problem in your view is the tech company multinationals where they do not have a substantive business here, but the issue I want to come to is the resource based companies. You are saying that, because of the dividend imputation et cetera, other companies are perhaps not the big issue, but we have had a lot of evidence to say that the resource based companies in Australia are setting up marketing hubs exactly in intergroup arrangements—marketing hubs in Singapore in particular—whereby they get their maximum deductions in Australia for R&D and other concessions but then shift their profit to Singapore, which is a low-tax jurisdiction, so that Australians are not actually getting the benefits that we should be getting from the extraction of our resources. You seem to imply

that the resource based companies were in a different category from, say, some of the big techs, so I am interested in your response to that, because it seems to me that we are being ripped off.

Prof. Vann: I drew a distinction between three categories: foreign corporates who operate here; Australian corporates who more or less only operate here like our supermarkets, our big banks and so on; and then our Australian corporates which do have significant foreign operations or customers. The marketing hubs issue is well known. The amount of profit that is shifted compared to the profit those companies are making I think is very small. I am not saying it is an issue which should not be addressed; the ATO is challenging it. It is well known. It is in the papers regularly that the Commissioner of Taxation said we are going after the marketing hubs. It is a transfer pricing issue. They do actually have people offshore who sell their stuff. Some profit has to be allocated to that activity. The question is how much. The ATO says they are allocating too much. They will say what they are allocating is not too much.

So I am not saying—and did not mean to give that impression, but it is difficult in a short statement not to make short statements—that Australian corporates do not engage in tax planning. What I am saying is it is more at the edges. It is not that they reduce their tax more or less to nothing, which the evidence seems to suggest some of the American companies in the digital economy—they still pay tax to a significant degree on their operations in America, but in the rest of the world they pay virtually nothing, and that is largely driven by transfer pricing. That is why Google's profits end up in Bermuda. Most of their offshore profits end up in Bermuda. They are not taxed in Australia or anywhere else. That is because they are moving intellectual property. That is very different from moving a bit of sales activity. So the amount of profits they can shift is virtually all of their profits. The amount of profits that Australian resource companies can shift, I suspect—I have no inside or actual knowledge of it, but from what you read in the newspapers, I suspect they are arguing over what seem to be big numbers in one sense but in the overall context of the amount of tax those companies pay, I think you will find it is a fairly small numbers. Their big mines are in Australia. It is very difficult to move the mine. And we know the iron ore price second by second, so what they can move they have to justify in saying they have all those people over there, they are doing the selling activity and some profit should be allocated to them. I think that is very different from moving intellectual property to Bermuda and all of the profit along with it. I am not saying there are no risks with resident companies, but I think our real risks are with the foreign companies.

Senator MILNE: If you could change one thing domestically notwithstanding the OECD process, what would you change in tax law or one of those associated laws in Australia that you think would make a significant difference?

Prof. Vann: To what?

Senator MILNE: To the ability of corporations operating here to avoid their tax.

Prof. Vann: I guess I would probably not change very much. I would give the ATO more resources. Hopefully, out of the OECD much more information will flow. But I agree with Professor Sadiq and Professor King that there are real systemic flaws in the transfer pricing rules. I do not think there is something we should fix on our own, because, if we are out of line with everyone else, it just creates everyone chasing the dollars, and that at the end of the day will be bad. I think what I would change is being very strong on adopting what comes out of the OECD process.

Senator MILNE: But, if nothing comes out of it because the US frustrates it, we are all back to the same position.

Prof. Vann: I think the US, as I have said, is at the moment different from last time. It could have already put its hand up and said, 'We're not going to go along with this.' I do not agree with my friend Antony that the US is trying to undermine BEPS. I know the US people involved in it. They are trying to get the result that they would like, which is that America can collect more tax from some of the companies, but they are the Treasury. They are not the Congress. The problem in the US is the Congress. You cannot get any tax legislation through Congress, and so they cannot go either way. But, as long as the US sits there and does not object, the process will go ahead. I did not mention it, but there is a comment in my paper that the BEPS outputs are being designed very carefully to inoculate it against US inaction. There are things in it called defensive rules which, in effect, say that, if the US does nothing, the other country can take the money. That is going to be a powerful incentive for the US down the track. So I do not think there is any particular thing that we should do at the moment. I could give you a list as long as our arm of many technical fixes that I think should be made in our law, including in this area, but I do not think there is any one change you could recommend which would produce a bucket of money overnight.

Senator XENOPHON: Professor Vann, you say that it is preferable to have a multilateral approach. That is axiomatic. In the absence of that multilateral approach, perhaps a unilateral approach such as a diverted profits tax or an iteration of it is better than doing nothing.

Prof. Vann: I do not disagree with that, but what I am saying it is a careful judgement. You have to push the boat forward but not rock it too much so it sinks.

Senator EDWARDS: That is because of our global community, what market signals that sends to all the companies and the distortion that Australia would suffer by virtue of being out in front on this?

Prof. Vann: Yes. For a country like Australia, staying within the pack is a good strategy, but you have to look at your national interest in staying within the pack. It has been our international strategy for many years essentially to stay within the pack, not cut our rates aggressively. I am not saying the diverted profits tax or something like it is a bad idea; I am just saying that, if everyone introduced one, that would be a problem because they would all be different, they would not be harmonised and then we would have break-out.

Senator EDWARDS: The Treasurer's rhetoric on this has been quite strong in the last couple of years. What advice would you give him? I think you said there is a list of recommendations as long as your arm. Are there any concerns you have about the current rhetoric coming out of the government? Be careful what questions you ask, of course!

Prof. Vann: There was the document, which I am sure did not go out without the Treasurer having read it very closely, that in effect says we need to collect less corporate tax, we probably need to get rid of our imputation system and we probably need to cut our corporate tax rate, and on the other hand he says we have all these evil, tax-avoiding multinationals and we should be collecting more tax from them. Overseas, it will be perceived as a mixed message: 'Are you saying you are friendly to us or that you are going after us?'

Senator XENOPHON: We did not say they were evil; we just said they were thieves—there is a difference.

Senator EDWARDS: But doesn't that imply that there is an awareness by the Treasurer that there is a substantial quantum of revenue which he believes that we should be capturing and we are not?

Prof. Vann: I think there is a quantum of revenue and I agree that we should be capturing it. I do not agree, technically, that a number of these structures actually work, because I doubt whether they are implemented in accordance with the way they were designed. But I do not think there is a bucket of money that you are going to collect. The UK diverted profits tax will collect less than $1 billion over three years.

CHAIR: The PBO estimate on a diverted profits tax in Australia, as I understand it, is based on costings that were done based on the UK proposal last year. So, in fairness to the Treasurer, there is not actually a proposal by him on the table; there is a discussion. But what the UK model would have been if introduced was looked at by the PBO and showed a figure as low as, I think, $90 million over four years.

Prof. Vann: Yes, and that is not a reason not to address the fact that there is—

Senator EDWARDS: If it is not a problem, why are we here?

Prof. Vann: Because we will all start saying, 'If they can get away with it, why should we pay tax?' It undermines the morality of the tax system.

Senator EDWARDS: I get it, and I think we are all very concerned about it, but that is the legislation in the UK, which is not addressing the issue; it is tinkering around the edges—that is the assertion—rather than taking the hard line. It is fair to say that Australia is taking a lead in the G20 on these discussions, is it not?

Prof. Vann: We were the president last year, so it was hard not to take a lead. Having said that, we tend to overstate our role in that process.

Senator EDWARDS: What else would you do, then, to be more omnipresent in this space if you were the Treasurer?

Prof. Vann: I would be pushing for the OECD and the G20 to keep the political consensus and doing everything we can to keep that political consensus. Political consensus, as you know particularly, is an extremely fragile animal, and it is something that has managed to hold together. Everyone in America thought this thing would fall over, not because of the US but because the political consensus would crack. The political consensus has not cracked. I think that is the most valuable commodity in town in this process at the moment. We have to push through and get the process done and then start implementing it. Rather than diverting Treasury resources—the Treasury has lost a lot more people than the ATO proportionately in the tax area—its resources will be better spent not putting in some short-term measures. Once BEPS is finalised, if our measures were contrary, presumably we would change them. We should put the resources into keeping the consensus and then implementing what comes out of the process. That will be a significant legislative program.

Senator KETTER: Earlier on, you talked about delivering a bucket of money out of this process. Looking at the figures, Australia's company tax revenue as a proportion of GDP is already above the OECD average. Do you have a gut feeling as to what the potential is for increasing that? Let's say the international process proceeds and there is some degree of success with all of that work. Would you care to give us some figures on that?

Prof. Vann: If we got an extra $1 billion a year out of it, not over the forward estimates, I think we would probably be doing very well. As to the reason we collect so much corporate tax, the other country that is very high is Norway. Why are they high? Because they have a lot of oil. Why are we high? We have a lot of iron and coal. Our corporate tax revenue is going to be dependent, essentially, on the prices we get for our natural resources. That is going to have a much bigger impact than anything that comes out of the BEPS process or anything else—in the area of corporate revenue. On the tax system as a whole, people want to see companies not dodging taxes. That sends an important message. That is why the process is important as an equity and also an efficiency matter. It means multinationals can avoid taxes more easily than local companies. That does not seem right either. But I do not think this is largely a revenue exercise. It is an exercise of making sure that in one important and very public area of our system the rules are working properly.

Senator KETTER: Which companies do you believe are the worst offenders in this area?

Prof. Vann: In Australia I am not sure that there are any who match the ones who are being named internationally, which tend to be the tech companies. But it is not just the tech companies. People have done work on Zara. I know our Treasury has done work on Zara, for example. Zara ships about 25 per cent of its profits into the Netherlands and Switzerland, where it is not taxed. Starbucks: is Starbucks a tech company? No, it is selling coffee.

Senator XENOPHON: Doesn't Starbucks repatriate its profits to some tax haven because of its logo? There is some nominal value put on its logo.

CHAIR: Netherlands.

Prof. Vann: People are buying the image not good coffee.

Senator XENOPHON: You are assuming it is good coffee, as well.

Prof. Vann: That is how the profit has been shifted out of the UK. It is a bit more difficult with Google and Apple. As you know, they stopped deducting the royalty they were paying because people were occupying their stores buying one cup of coffee and occupying all the seats, so they could not sell any more coffee for the day. There was a real consumer backlash in the UK. It had a real impact. But it is very difficult to have a similar kind of popular campaign for some of the tech companies.

Companies with a lot of intellectual property are the ones who have the biggest opportunity to shift the profits. That is not just the big tech companies, but most of our companies. BHP has intellectual property in the form of the way it mines and the technology it uses. But, compared to its value, that is a relatively small part of its value. For Google, Apple et cetera, their intellectual property is a much larger part of their value. They are the companies where the profit shifting is greatest. There is a lot of anecdotal stuff. You can look at many companies around the world who do engage in this. It is more difficult for our companies because they are big resource companies or because they are essentially local companies. They are big companies but with mainly a local market—and that is much harder to shift profit out of.

Senator KETTER: In terms of our current legal framework for addressing compliance and for tackling avoidance, how effective has that been in protecting our revenue base?

Prof. Vann: I will say a few words and then let my colleagues answer. I had a comment in the paper that the ATO historically has been seen as unstrategic. It has not been good at identifying the real revenue risks, and it has not been very good at addressing them. I think it is getting a lot better. You will hear from them today. Unlike the drift of some of the questions this morning, I agree that there is a problem of the revolving door. But I think that is a problem mainly in the transfer pricing area. I think the revolving door at the top of the ATO is a good thing because it is changing the direction of the ATO. They are becoming much more strategic about picking the fights, picking the areas and implementing them. They have not been very good at implementation in the past.

Senator KETTER: Unless somebody else has a comment on that issue, I would like to go to something you mentioned a bit earlier, Professor Vann. We had been talking about the staff reductions at the ATO, and you touched on staff reductions in Treasury as possibly being more important to consider. Could you elaborate on that please?

Prof. Vann: Well, I know more about Treasury because I have more to do with the Treasury nowadays, although I had a lot to do with the ATO in the past. Treasury have lost about a third of their workforce, and out of

the tax area—where you have got tax reform, you have got BEPS, you have got all these things going on—they have lost a huge proportion of their workforce, and a lot of the people they have lost have been very experienced. So it is very difficult for them to do the work that they have to do at the moment. It has always seemed short-sighted to me, on the revenue-raising side, to apply efficiency dividends in the form of staff cuts to those areas.

The ATO has been more shielded, so that although the ATO has been subject to efficiency dividends in virtually every budget in the last decade, there is also a pot of money that is handed to them for a particular project. So people can say, 'yes, the ATO has just gone through a lot of staff cuts', but also they are hiring people in other areas. I do not think you will find that their numbers now are significantly different from the norm of the last decade. They go up and down but they are around 20,000-plus mark, typically. It is how you use the resources in the ATO, I think, that has been the problem. But they know better than I do—I am not very close to it now—what impact the reduction in staff resources is having.

Senator KETTER: Again, I am not sure who my next question is best directed to. Professor Vann, you have made some comments about the UK's attempts to address this issue. You have been less than complimentary, I suppose, about that. Are there any other OECD countries that have taken any steps in this area which we could look at?

Prof. Vann: Yes. Within Europe, the European Union has changed one of their directives to address one particular form of base erosion which is a payment from a subsidiary to a parent company, which in the subsidiary's country is seen as interest and deductible, and in the parent's country is seen as a dividend and exempt. The EU has changed its law to say that if it is deductible at source, it is not exempt in the resident country. We changed our law last year—section 23AJ as it was; section 768-5 as it now is—in the exact opposite direction. We have encouraged a system where you can deduct in one country and exempt in Australia; I will not go into the technicalities of it. But the draft legislation for that came out on the eve of the Tokyo BEPS summit which Australia mounted last year, and it just surprised everyone who was there. So that is an example: we could change our participation exemption to say that if it is deductible in the other country, it is not exempt here. Europe has done that as a whole. In addition, a number of countries, like France, in Europe had already done it independently, knowing that the EU was going to do it anyway. So there are things, but they are not the big picture; they are things which have already been agreed within the BEPS project and are not going to change. Some countries are implementing those. That is very different from that diverted profits tax, which is not an area where agreement has been reached yet.

Senator KETTER: On the initiative that you have just talked about which has been implemented in the EU, are you able to put some figures as to how that might improve our revenue base?

Prof. Vann: I suspect Treasury would score it as a star, which means the revenue is not material. These things are an accumulation. The hope in the UK is that the diverted profits tax will collect exactly nil because Google will set up an office in the UK and pay ordinary corporate tax. The diverted profits tax is set at 25 per cent. The UK corporate rate is 20 per cent. The idea is that companies will give up their tax planning and just bring themselves into the system and pay the ordinary corporate tax. So you will never know, and it is very difficult to score, what the number is. But, as was said, the number is not large.

Senator KETTER: Often it is not the main game. It is the change in behaviour which is—

Prof. Vann: A change in behaviour and a change in perception.

Senator CANAVAN: I want to take a step back and ask a more fundamental question. My dad hates paying tax; he proudly engages in the national sport of trying to minimise his tax. He thinks any extra tax he pays is more for us to waste. I remember as a kid he used to tell me nightmare stories about the ATO—how they could come into your house late at night, take all your stuff, they have all this power with the anti-avoidance rule and other things. If you ask most small businesses and families whether the ATO has too few powers, I do not think their reply would be 'yes'. Yet we are here arguing about it, saying that they do not seem to have the powers to deal with these large businesses. Why is it that they have enough power to deal with small businesses in Australia but not large businesses? What is the fundamental problem?

Prof. Vann: Resources. Small business has zero resources; the ATO has a lot compared to them. When you come to the multinationals, it is the other way around. Relatively, the multinationals have a lot more resources that they are throwing at this than the ATO can throw at it. And the multinationals are used to dealing with tax administrations around the world. For most small business people—I am partly in that category; I do not ever want to be audited by the ATO; I do not have any tax planning; I just pay the tax—it is an uneven fight. Whereas for the multinationals, it is uneven, but it is uneven the other way. That is very difficult—

Senator CANAVAN: Is the problem, then, not the laws, but the appeals process or the court processes that allow large companies to employ tax experts and make court cases extremely costly? Does that make the ATO risk averse from taking on actions?

Prof. Vann: There is an element of that, but I think the structure of the rules at the moment—transfer-pricing rules in particular—makes them hugely information intensive. The companies have the information, but the ATO does not and the ATO has to extract the information, which is very difficult. Companies do not come and say: 'We know you want all the information which will show that we should pay more tax. Here it is.' They disclose what they are asked to disclose, but they disclose the least possible information that may damage them. They are the only ones who know the information. You cannot tax what you cannot see, and that is the problem with our transfer-pricing rules at the moment. It assumes the ATO can learn the truth about what the companies are actually doing—where their value-adding actually occurs. That is very difficult.

Senator CANAVAN: How do the court systems work right now? Is it a tribunal or an arbitration process? Are there appeals? If they are going to have a fight about an arcane dispute on transfer pricing, how long can companies drag such a case out? How much would it typically cost?

Prof. Vann: We have only had two of those cases in Australia since 1963—transfer-pricing cases on the substance, as opposed to the strategy or the procedure. The ATO lost one of those; it half won the other. One of them involved $1 million in tax; it would have cost each side about $5 million to fight the case. I have never understood why that case was fought. The other case involved a lot more tax; the ATO would have spent millions, but they got about another $50 million in tax. It would have been 10 years before that case was heard.

Senator CANAVAN: Are cost orders applicable in such cases?

Prof. Vann: If the ATO loses, it has to pay the costs. In both cases, the ATO did not completely lose—it mainly lost one and partly lost the other. I suspect that in the one they partly lost, each party paid their own costs, but I would have to go back and check. In the other the ATO would have paid most of the costs.

Senator CANAVAN: Professor Ting, you mentioned the general antiavoidance rule. I want to drill down on that. I understand we are one of the few countries that have something like this. Why can't that be used more broadly to tackle these issues? If a structure is put in place for the primary purpose of avoiding tax, why can't we use that rule?

Prof. Ting: You can ask the same question to the ATO.

Senator CANAVAN: I certainly will.

Prof. Ting: They will have a much better answer. Basically I understand that part IVA will apply if the ATO can prove that the dominant purpose of the structure is tax avoidance. As Professor Vann just mentioned, the problem is information asymmetry: multinationals have all the information and the ATO has just information provided by the multinationals. In a real case that is very complex it is very difficult for the ATO to have enough information to substantiate that the dominant purpose of the structure is tax avoidance because multinationals will always put up a lot of commercial reasons and they have industry experts and so on to prove that commercially they have to do it that way. So it is very difficult for the ATO to argue successfully on part IVA on these kinds of structures.

Senator CANAVAN: Basically they need as much information to do that as they would for the transfer pricing case, is that what you are saying?

Prof. Ting: Yes.

Senator XENOPHON: Given Senator Canavan's dad's fear of the ATO, maybe a cup of tea with Chris Jordan, the Commissioner, might be in order! Professor Sadiq, in relation to the Parliamentary Budget Office's work in respect of the unilateral introduction of a so-called Google tax, a diverted profits tax, there was fear expressed that it could provoke revenge taxes being imposed on Australian businesses operating overseas. How likely do you see that as a scenario? Do you see that as more of a fear campaign not to do anything unilaterally in the absence of a broader multilateral action?

Prof. Sadiq: That is a difficult question to answer because it is hard to know what other countries plan to do, but it is part of the reason why I think it is very important to keep working with the OECD and the G20 on the BEPS project so that we do not necessarily have to get to the stage where we go for the second-best option and look at something like a Google tax. We do not want all of these unilateral approaches that do not marry up. That is the worst-case scenario. We want this collaboration. I agree with Professor Vann that the BEPS project is very different now to what we saw previously. The US may not be quite so negative about it but the other thing is we

have a very different group of countries involved now. We have the BRIC countries playing a fairly large role in the OECD BEPS project which we had not previously seen. The OECD has been very inclusive.

Senator XENOPHON: Sorry, can I just interrupt because time is limited?

Prof. Sadiq: Yes.

Senator XENOPHON: I am happy for you to answer this on notice if you want.

Prof. Sadiq: Sorry.

Senator XENOPHON: That is okay. A multilateral approach is preferable but it may be that the Australian government will in the budget come up with a Google tax—and I know our Treasurer has been in discussions with his counterpart, George Osborne, in the UK. How likely do you think it is that it will provoke some multilateral retaliation? Do you think that is a bit overblown in terms of Australia being punished by other countries by simply trying to get some of these high-tech companies paying their fair share of tax?

Prof. Sadiq: In essence, I think it is probably overblown.

Senator XENOPHON: Thank you. Senator Canavan touched on tightening the part IVA provisions. Professor Ting, would you mind providing on notice, sooner rather than later, your thoughts on that because that might be very useful to the committee?

Prof. Ting: Yes.

Senator XENOPHON: Professor Vann, you mentioned—and perhaps I did not get it quite right—that international tax minimisation has now been made easier rather than more difficult as a result of some changes to our tax laws about a year ago. Is that right?

Prof. Vann: Yes. What is called the participation exemption now applies to things that are not shares and that means they are more likely to be deductible in the other country and exempt here. Why we made that change—

Senator XENOPHON: I am not sure how that one slipped through this committee, Chair.

Prof. Vann: I am not quite sure. When it came out I was with a bunch of people from some of Australia's largest companies and they all shook their heads and said, 'What are they doing?'

Senator XENOPHON: All right. Could you, on notice, provide us details as to how you think it could be tightened up in respect of that.

CHAIR: Strangely, we are running on time. We do appreciate you taking the time today, Professor Ting, Professor Sadiq and Professor Vann. Thank you for your participation at our inquiry. I know you have taken a few things on notice. We may call on you again for some of your technical expertise, as we go through this process.

Proceedings suspended from 10:30 to 10:46

CRANSTON, Mr Michael, Acting Second Commissioner, Compliance Group, Australian Taxation Office

HASTINGS, Ms Debbie, First Assistant Commissioner, Review and Dispute Resolution, Australian Taxation Office

HIRSCHHORN, Mr Jeremy, Deputy Commissioner, Public Groups, Australian Taxation Office

JORDAN, Mr Chris, Commissioner of Taxation, Australian Taxation Office

KONZA, Mr Mark, Deputy Commissioner, International, Australian Taxation Office

MILLS, Mr Andrew, Second Commissioner, Law Design and Practice, Australian Taxation Office

CHAIR: Welcome. I do want to note and acknowledge that this committee has the incredible opportunity to work with the Australian Taxation Office during our estimates process. We have always found them very forthcoming. I also want to thank the commissioner and the tax office for the sensational submission they have made to this inquiry. I know there are a fair few journalists here—if you have not had the chance yet, it is available on our website. The submission is quite detailed and tackles some very big issues. I know those things take a lot of time and work to put them together, Mr Jordan, so thank you for it. Mr Jordan, do you want to make any opening remarks?

Mr Jordan: Yes, I would like to take about five minutes or so, if I could, and thank you for this opportunity. I provide the comments today as Commissioner of Taxation but also as a member of the OECD's Forum on Tax Administration, of which I am now a vice-chair with responsibility for the Joint International Tax Shelter Information and Collaboration initiative. As you may know, I also bring more than 30 years in the tax profession. I was a member and then chair of the Board of Taxation since its inception in 2000. I was chair of the Business Tax Working Group, chair of the New Tax System Advisory Board advising on the implementation of the GST, and I have experience as an adviser to both sides of government.

I will start by saying that the ATO's overall experience with large corporates is a fairly positive one. We believe the majority of corporates do pay the right amount of tax in Australia and, importantly, are open and transparent in their dealings with us. There are a small minority who try to avoid their obligations and I want to assure the committee we act on behaviour that is questionable. When we find evidence of deliberate noncompliance we take strong and determined action. We pursue those who do the wrong thing, to bring them to account, to ensure future compliance and, importantly, to demonstrate fairness of our administration and of the system.

We include in the large corporate segment different types of taxpayers: large companies, typically with a turnover of over $250 million, very wealthy individuals and their private companies, and multinationals. We have comprehensive strategies for the different types of corporates. For all of these taxpayers we use a risk-differentiation framework to determine their risk rating. The assessment is based on a combination of their behaviour, transparency, history and revenue impact. Corporates are rated in different quadrants, based on the likelihood and consequence of noncompliance. That rating informs our decisions about what attention and treatment is needed. We monitor the activities of all large corporates, and most are rated lower risk, reflecting a good history of compliance and, importantly, an open, transparent and engaged relationship with the ATO.

We currently have 69 higher consequence taxpayers. This rating is based on size, not risk. These taxpayers account for 42 per cent of the revenue of the entire corporate tax base. So 42 per cent of the entire corporate tax base is within those 69 large taxpayers. They typically have an income turnover of more than $5 billion each year. We have a total assurance coverage across all of these taxpayers. Our assurance includes pre-lodgement compliance reviews, advance pricing agreements, annual compliance agreements, reviews and, in some cases, full-blown audits. Most of our effort is on real-time and future compliance, tax governance and risk management. We are in constant contact with these taxpayers to work through risks and issues as they arise rather than trying to unpick things after the fact. However, we do not always agree with these taxpayers, and each year we have around 100 matters—so, for that group of 69 companies, there are around 100 issues or matters that we have under review or audit. An audit is a much more comprehensive investigation, where we rigorously test the assertions, structures and arrangements.

I have noted media recently saying that the ATO has gone soft and has a tendency to settle with corporates. Whilst we do look to engage earlier and solve issues more quickly, we will continue to use litigation where there is a need for law clarification or if a message needs to be sent that certain behaviours are simply not acceptable. We will also not hesitate to pass on information to the Commonwealth Director of Public Prosecutions and law enforcement agencies, where appropriate.

As we mentioned in our submission, post the global financial crisis, large corporates have seemed to de-risk their tax positions and have become more open and transparent with us, meaning they have moved out of our highest risk quadrant. For the segment that includes wealthy individuals and their private companies, about 30,000 taxpayers present to us as high risk. For these taxpayers, we run real-time assurance checks, integrity checks, reviews and again, in some cases, audits. Our attention is drawn to poor tax and economic performance, and we scrutinise large, one-off or unusual transactions, including wealth shifting. We also pay close attention to the abusive use of trusts.

We use intelligent, sophisticated data-matching and analytics to identify activities and relationships between private group entities, including wealthy individuals, companies, trusts and partnerships. Our capability is growing significantly in this space. Last financial year, for example, we raised more than $1 billion in additional tax liabilities from our audit and review work with this market segment. Consistent with our work with large corporates, we are increasing our engagement with the top 1,100 individual taxpayers by wealth and income and moving more to a prevention-before-correction approach. As you know, later this year we will also be publishing key data from the 2013-14 tax returns on those companies with a turnover of greater than $100 million.

Regarding multinationals, my message is that we are doing everything we can within existing laws to ensure multinationals pay tax in Australia on the income they earn here. We have more specialists than ever before working in our internationals area and have strong leadership and capability to deal with global issues. The areas we focus on in this respect are base erosion and profit shifting, and offshore tax evasion, and there is much more collaboration across jurisdictions with the tax agencies. Our approach is twofold. Firstly, we do what we can now with our current law, our current joint compliance initiatives, to challenge the assertions, behaviour and operating principles of some individuals and multinational enterprises, including ensuring that profits are taxed where the economic activity takes place and where value is created. Secondly, we will continue to work with Treasury and our international counterparts on the OECD base erosion and profit-shifting action plan.

As I mentioned earlier, this year I have taken on a role as vice-chair of the OECD Forum on Tax Administration with responsibility for revitalising the JITSIC network, which is the Joint International Tax Shelter Information and Collaboration project. The JITSIC network focuses specifically on tackling cross-border tax avoidance and evasion. It started in 2004 with just four countries—Australia, Canada, the US and the UK—and it has grown over time to nine countries. At Australia's instigation, we now have 38 member countries agreeing to work together on specific projects. This is an unprecedented level of collaboration between 38 tax authorities worldwide. We are also cooperating within our own region. Late last year I established a permanent task force with the tax commissioners of 17 jurisdictions from the Asia-Pacific region to actively share compliance tactics and intelligence, and these are very practical steps we can take now while we wait for the OECD to deliver their reform.

Let me make one thing clear: with so many tax authorities committing to working closely together, at Australia's instigation, we will have much more timely and detailed information available to us on aggressive tax avoidance. I will be seeking tangible outcomes and developments in what can be a complex and difficult area of tax administration. But as I have said on many occasions, there needs to be a practical and coordinated global response to tackling multinational tax avoidance and we have the following strategies and initiatives in place. We have a much better intelligence and risk assessment domestically and across the globe, using AUSTRAC data, referrals from law enforcement agencies, accountants, lawyers and financial institutions. We have exchange of information with treaty partners, which allowed us to raise an additional $730 million in liabilities between 2012 and 2014. We also benefit from informants and leaks, and since 2006 we have identified about 1,900 Australians and offshore promoters. We have undertaken about 800 audits, reviews and nudge letters, resulting in $340 million in liabilities being raised and 18 successful prosecutions. The introduction of the common reporting standards will significantly increase the availability and quality of offshore data, adding to the data we receive from informants and leaks. We also always encourage voluntary disclosure, and our recent offer of concessional treatment for taxpayers to make disclosures of offshore income and assets brought people back into the system. Under Project DO IT, which closed in December 2014, we anticipate the disclosures of $600 million in income and $4 billion in assets.

We also have a strong enforcement program called International Structuring and Profit Shifting—or ISAPS. This program explores business models and challenges assertions there is no or little taxable presence in Australia and it focuses on joint compliance with international counterpart tax agencies. This work of piecing together the international picture of a multinational does not simply happen overnight, and I want to assure you we are making significant progress in this space. By 30 June 2015 we will have conducted around 200 reviews and 41 audits

under ISAPS, and to date we have raised in excess of $250 million in liabilities. We are also confident we will deliver our revenue predictions of $1.1 billion by 2017.

The cross-agency task force for Project Wickenby is playing a pivotal role in the Australian government's fight against tax evasion and crime, with audits and reviews of nearly 5,000 offshore scheme cases, more than two billion in revenue raised and 44 criminal convictions. Our very close working relationship with ASIC, AUSTRAC, the Australian Federal Police and the Australian Crimes Commission has been critical to the success of Wickenby, and we are now discussing a new framework to share even more capability and intelligence in the future to prevent people from promoting or participating in the abusive use of secrecy.

I want to reiterate that we believe most large companies in Australia are paying the right amount of tax under our laws. We have good coverage and visibility of most of them and work actively to ensure that levels of compliance are high. I have provided the committee with an ATO submission addressing your terms of reference. As you mentioned, today I do have relevant ATO executives with me to enable a full discussion of the issues. We have Second Commissioner, Law Design and Practice, Andrew Mills; Acting Second Commissioner, Compliance Group, Michael Cranston; Deputy Commissioner, International, Mark Konza; Deputy Commissioner, Public Groups, Jeremy Hirschhorn; and First Assistant Commissioner, Review and Dispute Resolution, Debbie Hastings.

I would like to finish by saying that all taxpayers need to have confidence that confidentiality will be maintained over their taxation and commercial information. Disclosing confidential taxpayer information raises issues for the future for all taxpayers in terms of our ability to facilitate transparency, cooperation and productive relationships with them. For these reasons I do not wish to discuss confidential taxpayer information. If the committee wishes to pursue this detail, you may wish to consider asking specific taxpayers about their own tax affairs. I want to give the Australian community confidence we are doing everything we can to administer the tax system fairly. You can trust us to get the balance right between help and enforcement and to pursue those who are playing on the edge or simply doing the wrong thing.

CHAIR: Thank you so much for that. Thank you for the detail. There are quite a few talking points from that. I note that we have quite a bit of time with you and your team, so I will give senators an opportunity to engage in longer lines of questioning. We may cut slightly into the lunch period, and I apologise if we do that. I will start. I want to ask you some questions, Mr Jordan, about some of the decisions that you have made around public interest immunity. Before I do that, however, I want to put on the record that people like myself and others are incredibly supportive of the efforts that the ATO has undertaken. This committee has previously heard evidence from a whole series of organisations praising the work that the Tax Office has done in outreach and in engagement with other agencies. That is a testament to the amount of support that you experience as Taxation Commissioner across a series of agencies and across the political divide.

That being said, I want to refer to a series of letters between you and I regarding the decisions around public interest immunity. Let me begin by putting on the record: the decision to take public interest immunity is a decision that you have a right to make. As a senator and someone who is a practitioner of the rules of the Australian Senate, it is within your powers, where you feel it appropriate, to make a public interest immunity claim and to then publicly justify why you have made that claim. I am not disputing your right to make the decision. I want to ask you some questions about why you feel that was the right decision to take. In doing so, I note that we, at our previous meeting, tabled a three-page letter. I am sure you have a copy of it with you. It was a response to a letter that was sent to you by me. It is entitled 'Inquiry into corporate tax avoidance and minimisation. Public interest immunity claim'. It is a three-page letter where you justify why you have taken the decision to take public interest immunity. I will ask you some questions specifically about that. Before I do so, the general question is: when you are making a decision to take public interest immunity, what is the basis upon which you make that decision? Before you answer that, for senators who may not be fully aware of the details—

Senator XENOPHON: It might be good to get some context.

CHAIR: It all comes about because there was a freedom of information request from the Uniting Church that was sent by Mr Jordan, or by the Australian Tax Office, to the Uniting Church that was heavily redacted following FOI guidelines. We asked the committee—

Senator XENOPHON: It might be worth explaining what the FOI request from the Uniting Church was, just for the benefit of the *Hansard*.

CHAIR: It was for a series of documents, most notably the LBI and disputes management report. Mr Jordan may be able to speak about the actual purpose of the report. It was an FOI request. Names and other information were heavily redacted. The rules around FOI requests are different to those around giving evidence to

parliamentary committees. I am not in any way suggesting that the redaction was not a proper or appropriate thing for the Australian Taxation Office to have done.

The committee requested Mr Jordan to give an unredacted public copy, noting that the rules of parliamentary privilege, which Mr Jordan and the tax office now experience, override any legal restraint over the publication of this information. While there is no legal restraint preventing Mr Jordan from giving us this information, he does have the right under public interest immunity to make a claim still not to provide that information. I assume you have some lawyers who think that is a fair assessment of it all.

The information specifically is about identifying companies that I believe may have, according to this report, engaged in some of the worst tax minimisation practices. I want an overview, Mr Jordan. What is the decision making here? You know my view on this. I believe it is in the public interest for the names of these companies to be out there, to allow the public to be informed. If companies are engaging in that level of aggressive tax minimisation, they should be prepared to front that publicly. Obviously, in your letter you have a different view. I want to give you the opportunity to put your case.

Mr Jordan: I think you fairly outlined in the situation in those remarks. There are various aspects of public interest, I suppose. It would be unprecedented for taxpayer-specific information to be provided in a public way. As far as I recall, this has not happened before.

Senator EDWARDS: Nowhere in the history of tax reporting—

CHAIR: I dispute that, but that is a different matter.

Mr Jordan: It is unprecedented for us to be disclosing taxpayer-specific information and in some cases commercial information relevant to those specific taxpayers. We are very happy to provide system data, aggregated data, that show flows in an aggregated sense. We are very happy to do that. We do have a very significant problem with providing taxpayer specific information. We need to be able to have transparent and open relationships with companies. We cannot have a situation where companies can argue they will not share information with us under a belief that it may become public.

CHAIR: Their sharing of information with you is their statutory obligation. They are not going to the tax office and saying, 'This is our taxable income' or 'This is information about our operation because you are nice people at the end of the street'. They are doing that because they have a legal requirement to do that. Are you saying that if you reveal information in the public domain, which you can do under parliamentary privilege—no-one is disputing that you have the ability to do that without legal ramification—Australian companies would stop meeting their legal obligations?

Mr Jordan: It comes back to a comment that I heard Professor Vann make in the earlier session. You either have a situation where companies openly come and discuss their issues, their proposed transactions, and provide us with all the information in a very open and transparent way, or they close down a little on that, and we then have to make this chicken-and-egg argument: did you do this and what did you do here? It is so much better for the system if we have a very open and transparent relationship with these taxpayers.

CHAIR: I put the other argument to you. You are putting an argument about what is in the immediate interest of the tax office. You are entitled to do that; you are the person to do that. What about the interests of consumers in being aware of some of this behaviour and who is conducting this behaviour? Companies are engaging in this kind of tax minimisation behaviour—behaviour that you have identified as being of high concern. We are not talking about every company. These are companies you have identified. Part of this is about what at times is the very grey line between what is tax minimisation, what is tax avoidance and what is tax evasion. You would know better than any of us at this table that there are times where there is a very grey line between what is a legitimate structure and what is a structure for the purpose of evasion. What would be lost by giving that power to the Australian consumer, the Australian taxpayer, to be able to make that decision? If these companies have behaved appropriately—if they have done nothing wrong, but they have engaged in these kinds of practices—then shouldn't they have to be able to justify that publicly?

Mr Jordan: As I said in my opening remarks, there are 69 companies that have turnover of over $5 billion that represent 42 per cent of the corporate tax base. I mentioned that we have about 100 issues or matters that we do not agree with. Clearly, some of those matters are those that are mentioned in those reports—mainly to do with marketing hubs—so we are in dispute with a number of those companies. That report mentions the type of activity that we do not agree with. It mentions the issues that we have; it is all about the level of mark-up that might be left, the profit that has tried to be shifted to places like Singapore or Switzerland in terms of the use of those marketing hubs. There is a lot of—not misinformation, but misunderstanding, I suppose—when we talk about figures of $60 billion, $40 billion, $11 billion—

CHAIR: The $60 billion is your figure from the 2011-2012 report, that went to 23 tax havens.

Mr Jordan: But people think that is $60 billion of tax or $60 billion of profit, when it is typically the gross sales; that is, sales income that is reported here in Australia. Product is sold from Australia to, say, Singapore—that is $60 billion. Singapore then on-sells it to somewhere else. What we focus on, and the problem we have identified, is the level of profit that is left in Singapore. So instead of the $60 billion going directly to somewhere and being slightly higher than $60 billion, they put people in Singapore, they transfer function to Singapore and they say that is a very valuable function and profit is left also. We are analysing and disputing with individual companies that level of mark-up and whether it is appropriate for what the functions are. There is a lot of misunderstanding around that side. I just want to make sure that people understand.

CHAIR: I want to get to the specifics of things like Singapore, and we will do that. I know senator Milne has got some questions about that as well. The broader point is that if there is confusion or a lack of understanding, surely the best way of dealing with that is to put all the information out there on the table and to take a higher level of transparency. I want to be clear that my issue is not with the efforts of the Australian tax office—I think the stuff you are doing with the special audit teams is sensational and world-leading. I think there is a lot of incredibly good things going on, but it all seems to be happening behind closed doors. Surely we can shine a bit more light on it and give the Australian public more information. If all of this comes down to the big issue of confidence, won't we be giving Australian people more confidence if they see what is going on behind the wall?

Mr Jordan: We are sharing all that information. We are sharing what is going on. We are just not naming individual taxpayers.

CHAIR: You are not. I have got an entirely redacted document here. I have got names of every business you—

Senator EDWARDS: Chair, you are verballing our witnesses.

CHAIR: I will let them respond.

Senator EDWARDS: I think you are on the same page. Mr Jordan has said that they are looking at marketing hubs. They are trying to get clarity in where profit shifting is going and he has clarified the revenues—they are talking about revenues of $60 billion. It is very hard, to use a term that has become well known to me recently, to unpack that as to what the actual profits are that should be paid—

CHAIR: Senator Edwards, I did not realise you were a spokesman for the tax office now.

Senator EDWARDS: You are making a point about the public interest. Let us operate in the public interest.

CHAIR: Senator Edwards, I am asking Mr Jordan a question.

Mr Jordan: I am happy to share the information, to share what the practices are and to share the activities. But we have a big interest—

CHAIR: And name the companies.

Mr Jordan: We have a big interest here in terms of the integrity and confidence—

CHAIR: Okay. Let us move on.

Senator MILNE: Can I do a follow-up on that particular issue, please Chair.

CHAIR: One quick question, because I have got a few things on this that I want to get to.

Senator CANAVAN: You have raised the issue, Chair. I think the other senators have a right to—

CHAIR: And you will have plenty of time.

Senator MILNE: Just in relation to this, you are arguing that the confidentiality and integrity of the tax system requires you not to name these companies. I would argue, together with the chair, that the community deserves to know who they are. But surely the way to solve this would be to legislate to require these companies, in their annual reports and their reports here, to say where their subsidiaries are and the relationship they have with their subsidiaries and/or parent company, wherever they are in the world. If that were done, then clearly all of us could go and follow up exactly what is being transferred. So, surely to fix this, don't we need to legislate now so that they are forced to name their subsidiaries and the relationships they have around the world, and where they are actually sending this money would then become a deterrent?

Mr Jordan: Clearly that is a matter for government, and that is probably in the Corporations Law, as to disclosures in annual reports. There are certain requirements of companies as to what they need to disclose as a minimum. That could well be a matter for government to seek to extend those disclosure laws. We do of course have the information about taxable income and sales and tax payable that will be disclosed with respect to the

June 2013-14 income year, which we will be doing later this year. We are getting all that information together, once all the returns are in, and that will be a partial way of more transparency for people to be able to look at that.

I should also say that the position I have taken here—and it is a judgement call, I accept that, and it is my judgement—is that it is better overall for the system to maintain the confidentiality of taxpayer information. In other jurisdictions—for example, in the UK, as I understand it, in all the inquiries that have been there that you would be very well aware of—they also would not disclose specific information about taxpayers. So I am not taking an unusual or different position from what most other like countries would do.

CHAIR: I have got one question from Senator Canavan and then I have got—

Mr Jordan: We are also going to have country-by-country reporting coming in in 2017 or after. That information will be confidential to the tax office but will give us a lot richer information about where the income and tax of these multinationals is being paid. We see that as a really worthwhile and relevant new initiative in terms of our ability. One of the things that is so important about those 38 countries that we have organised to share information is that some multinationals have played off revenue authorities. They have relied on the fact that we have not spoken to each other. One of the earlier witnesses mentioned this fact—that multinationals operate seamlessly across borders but we tend to have a very narrow picture. We are changing this. We are trying to have a better global picture of the actual operations and results of multinationals through this greater collaboration. This is really going to be a very effective leverage for us going forward.

CHAIR: I think there was one follow-on and then I have got a question.

Senator CANAVAN: I wanted to ask questions specifically to the public interest immunity and your claim that it is relevant to this discussion. Thank you, Chair, for your indulgence. Mr Jordan, can I just clarify? My understanding—and I am not a tax expert at all—is that we have an honesty based system, basically. I fill out my tax return and you do not really see a lot of what is behind my calculations, but you presume I am honest until it is proven otherwise and then you go after me. Is what you are saying that that system has worked well over time and, if we were to start disclosing information before a conviction or a charge had happened, or if you just disclosed an investigation, we might undermine that system of, basically, people providing information honestly and having a way of collecting tax that is fairly efficient and cost effective? Is that an accurate understanding of what you are saying?

Mr Jordan: I just want to address the first part of your question. All taxpayer returns—individual, small companies, large companies—go through our risk engines. We run the analytics over them just to see. We are getting to the stage for individuals who do MyTax where we are not far off having real-time analysis, as someone is putting in a figure for work related expenses, where there will be a little pop-up saying, 'Look; we're 98 per cent sure you're overclaiming here; do you really want to put that figure down?' because of the analytics about being able to look at your nearest best neighbour within your type of occupation, the sort of income you earn and your location. So our analytical ability is getting very, very good. We can identify and throw out of the system those people that have something unusual, and then we will ask those. We are only a couple of years off this real time filling in the return and having pop-ups. I think that will have an incredible effect on behaviour, because it is much better to have people doing the right thing at the beginning rather than coming back to unpack the detail and do it that way. That is the same for small business. We have just released a whole lot of our new benchmark figures that we run through—and similarly for the large corporates.

But, importantly, for the very large, for the 69, companies that we have a total constant surveillance of, we know what they are doing when they do it. It is total transparency. We might not agree with their suggested treatment of things, but we are not coming back in five years trying to find out what they have done. We know as it is happening. I think that is a very important principle to maintain, and that is why we have claimed public interest immunity to maintain that ability of confidential information. Parliament clearly expressed an intention when they put in place the secrecy laws in the tax act. That is a clear intention and statement by parliament that has never been overturned for decades: that they want the tax office to maintain secrecy of taxpayer information. If you break that sort of view, where does it go? Are we, every time we have a Senate estimates, then questioned on individuals, small businesses, whatever? It is a really strong principle to maintain going forward.

CHAIR: I will move on from the specifics for this reason. The view of the Australian tax office and my view on what is the public interest in this case is probably not going to see eye to eye. I will argue, and I will continue to argue, that the disclosure of this information is in the public interest. I respect that you have the right to make a determination within your powers that the public interest is something other than that. I will be pursuing how we can obtain this information. I will be writing to the Clerk of the Senate, Rosemary Laing, and asking her what powers the Senate has to be able to get some of this information. I accept that you will pursue your view—and

you are entitled to. I want to take you now to something in the specifics of the reasoning you have given. It is your decision, in consultation with the tax office, to make a public interest immunity claim. Is that correct?

Mr Jordan: Yes.

CHAIR: Who did you speak to in making that decision?

Mr Jordan: Clearly I spoke to the other second commissioners. I spoke to our legal counsel and to some other people like Jeremy and the people at this table.

CHAIR: Who outside of the Australian tax office and your lawyers did you speak to?

Mr Jordan: We spoke to the Australian Government Solicitor's office—

CHAIR: To get legal advice.

Mr Jordan: to confirm the legal advice. I notified the Assistant Treasurer's and Treasurer's office of my intention to make this claim.

CHAIR: Okay, hang on. That is not what you said before. Did you contact the Assistant Treasurer and the Treasurer?

Mr Jordan: We sent a minute to them telling them what we were intending to do.

CHAIR: I am just reading your letter. This is what you wrote to me.

The Treasurer has been consulted about making these—

public interest immunity claims—

and has endorsed them being made by me as an independent statutory office holder.

So, he has endorsed the decision?

Mr Jordan: Yes. He signed the minute agreeing—

CHAIR: I understand you are a statutory officer. You make independent decisions, as you should. Did you notify them, or did you consult with them?

Mr Jordan: We notified them.

CHAIR: But they endorsed it?

Mr Jordan: They endorsed that. The normal process, as I understand it, is that it is the responsible minister that makes the public interest immunity claim. We are in the difficult situation that the responsible minister is the Treasurer. We cannot tell him the information which he is making the public interest immunity claim on. So it is probably difficult for him to make the claim not knowing what the information is. I apparently, as a statutory officer, have that ability. Having that situation as to who is the responsible minister in this case or myself, we had them agree that it would be best for me to make that decision, and that they support me making that decision.

CHAIR: That is the point. You have here in writing that they endorse—

Mr Jordan: They agreed it and sent the minute back.

CHAIR: These letters are all public. The media can have them. These letters have been going back and forth since 20 March. That was when we sent the first letter to you, and there have been other letters that have come and gone during that period. There has been an exchange in writing. You said here, and I am going to read this again:

The Treasurer has been consulted about making these PII—

public interest immunity—

claims, and has endorsed them being made by me as an independent statutory office holder.

When did you send the minute to the minister's office?

Mr Jordan: Thursday last week.

CHAIR: And when did you get a response?

Mr Jordan: Yesterday.

CHAIR: I have got two different letters here from you, both of them saying—

Senator EDWARDS: Where are we going with this?

CHAIR: I am trying to work out how these decisions are made.

Mr Jordan: There are dates on letters and everything like that, and we are here today.

CHAIR: The initial one was on 2 April and then you sent me another correspondence on 7 April. Did you send this correspondence because you had got the minute back at that point from the Treasurer's office?

Mr Jordan: We held the letter that you are referring to until we got the minute back from the Treasurer's office, yes.

CHAIR: And you got their endorsement?

Mr Jordan: Yes.

Senator MILNE: I want to go back to the point I was making earlier that we can wait for the OECD but that could take a considerable amount of time. We have heard evidence this morning that the United States may not facilitate that in the way that we would like. So, in the meantime, there are things that we must be able to do. We heard evidence this morning that part IVA could be fixed up, for example. I have just asked the question on legislating to require more information under the Corporations Act to provide details around subsidiary companies. Would you like to comment on where you identify the problems as they currently stand which make it more difficult for the tax office to pursue the matters that you are clearly already pursuing but where you might otherwise not be taking action if things were tighter in terms of a legal interpretation?

Mr Jordan: Before I ask Mark Konza, the head of our internationals, to respond to the detail of that, I will just address this issue of part IVA, the general anti-avoidance provision. That is a last resort provision, and this is part of the difficulty. We cannot just simply leap to that and say, 'We think your dominant purpose is this.' You need to go through all the other provisions first, including transfer pricing. I think, as Associate Professor Ting mentioned in the earlier session, it is sort of the same level of detail and information and complexity. The provision itself is there and it is available, but very much as a last resort.

The problem we face is, as was alluded to in the earlier session, you will get 20 worldwide experts giving reports a metre high saying everything the company is doing is commercial, it is done for commercial reasons and nothing else, and we may take the view, 'It doesn't look too commercial to us.' It looks contrived, it looks artificial and it is shifting profit out of Australia, and some judge is sitting there with five or 10 barristers in from of him, going through the level of details. It is extraordinarily difficult. If I could just take one thing that is on the public record it would be the Chevron case, which is very recent, from the end of last year. Not to oversimplify it, basically, there was a borrowing at two per cent by the United States parent and an on-lending at nine per cent. As I understand it, there were something like over 30 expert reports. There were 11 barristers in the case. It took years to get up, and, in my view—maybe I am just too simple here—that looked like a pretty straightforward issue. If you just take that type of case that looks pretty simple on the basis of over 30 experts, 11 barristers, years to get up to court and documents like you would not believe and now try to translate that into a marketing hub where they are arguing that they are transferring function, that they are transferring risk, that they play an important part. It is awfully complex, and that is why part IVA in its current form, which is quite useful in most other examples, is a bit difficult to get over the line. It is a lot more complex.

Senator MILNE: That is why I am asking. What do we need to do to make it easier to get across the line? We have a case at the moment, I am sure you are aware of it, with News Australia Holdings et cetera where there is an obvious case of internally generated goodwill being set up to facilitate their tax arrangements. I would have thought that was in breach of part IVA of the tax act as a sham transaction. It is obviously there to dodge tax. Why can't we take a case, in that particular instance?

Mr Jordan: I will ask Mark Konza to address the international and maybe Jeremy Hirschhorn to deal with the specifics on the News.

Mr Konza: As the freedom-of-information documents disclose, we have been concerned about certain aspects for a long time. We have not been idle on it. We have been advising Treasury and advising government. We had major changes to the transfer-pricing legislation a couple of years ago. We had major changes to thin capitalisation about a year ago. It is potentially the case that part of the reason we are here today is that this legislation was quite recent, in tax terms. It takes long cycle times to get cases done and into court and get a court decision. At this stage, we have not got a court ruling on the new transfer-pricing provisions, which were substantially strengthened over the old ones that were shown in court decisions to have major weaknesses.

We do advise government when we think there is law change required. The part IVA question, specifically, is that there are certain thresholds for the application of a general anti-avoidance rule. You have to be very careful when tinkering with those because they will have, potentially, very wide application. The dominant purpose test is difficult for us sometimes, because large corporations are able to build very confused or murky or convincing cases about why different ideas were really the purpose of what they were doing.

We do work with Treasury on ideas that we have about strengthening things, like the general anti-avoidance regime, which is part IVA. But they then have to consider how that will apply to the broader tax system and how that will apply to trade and those sorts of things, and they advise government as they see fit.

Senator MILNE: I will have to stop you there. This is one of the big issues we have. The tax office is a statutory authority. Why do you not advise the parliament through your annual reports, and the community through your annual reports, of the ideas you have as to how we could do this better, rather than have the relationship with Treasury, which politicises the whole thing, and then government determine what it is prepared to do and who it is prepared to go after and what the consequences will be? Why does not the tax office in its annual reports set out the extent of the problem with profit shifting, for example, and the ideas it has about how parliament could fix it—as opposed to giving government a heads-up as to what it may or may not want to do according to who donates to it, effectively?

Mr Konza: Our public reporting for the last decade has been clear about our concerns about transfer pricing. As for the idea about what we think should be done about it, we need to recognise that we are tax collectors and there are other factors that need to be taken into account. That is where Treasury plays that valuable role. The enhancement of trade to development of employment, these are factors that need to be balanced.

Senator MILNE: I accept all that, but that is their job and the parliament's job to weigh that up. It is not the job of the tax collector to weigh up everything else. Surely it is the job of the tax collector to tell the parliament how it could do its job more effectively and then the other agencies can argue the case accordingly.

Mr Jordan: We do not see it in terms of other agencies. Treasury own taxation policy in our system. We advise them and they balance that with all their other considerations. Just to complete the picture about legislative change, you have probably already heard this morning that the global-tax architecture is what has to be changed, and it has to be changed on a multilateral basis. That is really where a lot of our effort is going.

Senator MILNE: You mentioned the change to thin capitalisation rules and how that is flowing through et cetera. We also talked this morning about the big four accounting firms, who are well ahead of the game in terms of moving on and getting around those rules and going to whatever they can advise their clients in relation to tax avoidance. Is it not true that, straight after those laws changed, they were then advising their clients to go around it, looking at ditching the safe harbour test in favour of the arms-length debt test or the worldwide gearing test? They are already ahead of the game in how to get around those. Is that why the tax office throws up its hands and goes to advance pricing agreements?

Mr Konza: There certainly has been a lot of movement in corporates on thin capitalisation. I do not have any figures about those tests that you are talking about, but, for example, there is the capacity for companies to revalue their assets. When you revalue the assets, you then get the benefit of the leverage ratio. We have identified a substantial revaluation of assets occurring in large corporates. We intend to support the change to the legislation with a compliance program that will be commencing in the new financial year to make sure that companies are doing the right thing. We lobby, if you like, for reconsideration of tax policy where we see problems. When the parliament passes those changes, it is then incumbent on us to support those changes, and that is what we intend to do in the coming year.

Senator MILNE: I want to go to the issue of advance pricing arrangements or agreements. Isn't that really the tax office just formalising the uncertainty, going to the point Mr Jordan made about the complexities of having all those barristers lined up—'So let's come to some agreement about how we are going to manage the uncertainty in the law and tax avoidance and go with those.' But the community loses heart when you get the expose, for example, out of Luxembourg, which shows you the extent to which companies have been misleading the tax office. I understand that, as a result of the expose out of Luxembourg, at least six companies have had their advance pricing agreements revoked. I would like confirmation as to whether that is or is not the case. If it is the case, have we actually prosecuted any of them for misleading the tax office? I understand that it is an offence to mislead the tax office, and now it has been proved that they have. They have revoked those pricing agreements.

Mr Konza: There is a combination of a couple of different issues there. The data that we received about the Luxembourg APAs and correspondence has been analysed by the tax office. There are about six companies where we think the data that we have received raises tax issues, tax risks, that we need to explore. In those cases, the data that we received has been sent to the compliance teams who are responsible for that company, and they will be working through those risks with the company.

Senator MILNE: So you are saying that there are no recommendations for prosecution at this point?

Mr Konza: They have not been investigated. All they are are things that we did not already know about. A lot of the Luxembourg leaks were either things that did not concern Australia or we had already analysed them and said there was no tax risk for us.

On the APA question, one of the important considerations is that APAs ease investment in and out of Australia. When companies want to make investment into Australia or Australian companies want to invest overseas, as far as possible they need to nail down what their after-tax earnings are going to be. APAs play an important role for us as a foreign investment destination by clarifying those things for those taxpayers. On the specific point of the APAs, we have been having another look at APAs, because we became concerned that APAs were becoming too concentrated on pricing of transfers between related party entities. The commissioner certainly 'encouraged', if that is the right word, me to get our staff to look more at the structures that were underlying the arrangements that were being put up in an application for an APA.

I was misquoted in the press as saying that we had revoked APAs. I did not say that. I said that a number of applications for APAs were denied. That is a different thing. What happens is that a person puts an application in, there is a substantial period of negotiation and investigation, and an APA is concluded at the end. The only case in which an APA would be revoked is where the commissioner feels that they have been actively misled by the taxpayer. That is not the case here.

In the six cases that we are referring to, we concluded that the structuring behind the APA meant that the type of cooperative approach which underlies APA negotiations would not get us to the truth. We concluded that we needed to conduct an audit of the underlying arrangements. So we said to those taxpayers, 'We're not going to continue with your application for an APA.' That is what those six cases were about.

Mr Cranston: There is a lot of intelligence globally that we are learning about businesses from other tax jurisdictions. The world is changing and business models that corporates are using are changing. Another reason we need to review some of those APA is to make sure that with regard to the laws that we are working with, the new transfer pricing profit-shifting laws and the business models that the multinationals are using, we are getting the right profits and the right tax on those profits in our country.

Mr Jordan: I think there was an expectation too. They are typically a two-year agreement and at the end of the two years there would be a rollover of it, and there would be some discussion as to whether anything had changed. When they have expired, we have taken the opportunity to really have a good look at some of the different business models and some of the different types of transactions. We are saying that we are just not going to automatically roll that over under the assumption that things have not changed, because in some cases we felt that the business models had changed somewhat from maybe even eight or 10 years ago when the original detailed negotiations were.

As Mark Konza said, I did encourage a broader view of the operations rather than a narrow pricing determination under whatever structure is there. That is what has opened this up. I have been criticised for not concluding APAs with taxpayers. I openly say that we are not going to do APAs unless we are absolutely satisfied on a broad range of factors, which include whether the structuring into Australia in a general sense is overly aggressive, and move it away from just the pricing.

Senator MILNE: Can I come back to the question I asked about News Holdings. Someone was going to respond to that for me.

Mr Hirschhorn: Without talking about specific taxpayers' specific examples, certainly restructures of groups do take place and they often have tax implications as well as corporate benefits. When we see that the tax benefits outweigh corporate benefits, the pre-tax benefits, we do seek to apply part IVA. In the public domain, we have pursued those sorts of arguments against News Corp on previous restructures and indeed have on occasion been unsuccessful in applying part IVA on the basis that there was a dominant commercial purpose rather than a dominant tax purposes. Part IVA has recently changed and that stops taxpayers arguing that they would not have done the transaction at all. So that was a defence that was often used by corporates against part IVA around corporate restructures that generated text benefits.

They said: 'We would not have done the transaction at all if there had been a tax cost.' Part IVA has recently changed and no doubt in the near future there will be cases in which the Tax Office seeks to argue the new part IVA against things like corporate restructures.

Senator MILNE: Notwithstanding that, I did ask a specific question about internally-generated goodwill as being one of the factors concerned. Will the new arrangements actually take that on?

Mr Hirschhorn: A corporate restructure could have a range of tax implications. Bringing intangibles like internally-generated goodwill onto a balance sheet or increasing the tax cost base of shares into Australia are

some of the potential implications of a restructure. Again, if we saw a restructure that we thought was done primarily for tax purposes, we would seek to apply part IVA. We have strengthened part IVA recently, which, in a sense, stops the defence of 'We would not have done the restructure at all if there were adverse tax implications.'

Senator MILNE: You have said that you have looked at news in the past and have cut through unsuccessful cases. Given the recent evidence on the $7 million in intangibles, is the Tax Office actively looking at this particular case?

Mr Hirschhorn: Again, I cannot comment on individual cases, but I think it is fair to say that we look, as Chris said, at the 69 largest groups and we are on top of everything that they do. We also look at significant transactions. I think it would be a surprise if we were not looking.

Senator MILNE: I would like to go on to the Tax Office's 'scheme sheets', which look at the intricacies of tax minimisation schemes. I understand the Tax Office holds a number of these scheme sheets. Can you explain to me how they are used for enforcement purposes?

Mr Cranston: We have looked at scheme sheets and typologies of taxpayer planning. Sometimes they inform us about whether the particular structuring or the minimisation steps are tax driven or commercial. They are also very important for us to educate our auditors and our staff about particular behaviours—especially if we see particular schemes that are used to avoid tax—to help them identify these in their enforcement work or their audit work. They also help us get an understanding of how to get evidence around some of these schemes and then we can inform Treasury about how patterns and trends of a particular scheme are being used. That gets back to what you were saying, Senator, about working with Treasury: we do work with them and provide evidence where we think that the law may need to be looked at.

Senator MILNE: These scheme sheets make it a secret forever that the Tax Office can effectively look at templates of how tax is avoided by various corporations. Why not release after a period of time? Obviously you would not want to release them as a template for companies to go about tax avoidance, but would it not incentivise the ATO to get some results? If after five years, for example, you released existing scheme sheets, you could use them to check the performance of the ATO's enforcement against known tax avoidance schemes?

Mr Cranston: Scheme sheets are not formal things that we do. It is a scheme we put on a sheet, but there is nothing in our law that drives us to do that. One thing that we have in our policy is taxpayer alerts, and they let the community know about a scheme in general terms. That is a warning to the community or advisers or taxpayers who were thinking about going into those schemes. So that is the more formal what I would call scheme sheet, and we provide those publicly. I am not quite sure in some of these—like why would we issue something five years later about warning taxpayers? If we were very concerned and we needed to notify them, we would either deal with them individually, if they are sort of customised schemes, or if they are at industry level we would deal with the industry. If it were big enough and involved enough taxpayers, we would go immediately and as soon as possible on those things.

Mr Jordan: If I could just add there too that it is very important that probably we could be a bit better and quicker at issuing these taxpayer alerts. My view is that to get something short and sharp out early is better than building a very detailed, comprehensive, long, technical expose of the schemes. That is something that, as a general proposition, I want the tax office to do better—is to get in the marketplace shorter, quicker notifications of our views on things, not just schemes but as a general proposition. And, where there are big issues floating around, it might be great to have two years of this wonderful, long technical document, but it would have been a lot better within three months to get something short out there—do it in instalments. So those are promoter penalties.

The other thing I should say on the promoter penalties is that we very much focus on the advisers to these things, because we have got the ability to zero in on the tax agents, the accountants, where their clients are lodging returns. We have a lot of analytical capability to aggregate claims of taxpayers and attribute that back to the agent. To take a simple example, if an agent seems to have every single client they have with work related expenses way above the benchmark, that just cannot be right, so we will go and visit that person. But, in the scheme area, there are now provisions that the accountants and advisers are putting in there that are up for what they call promoter penalties, so it is a lot better, in a systemic sense, to go after the promoters as well as the people, so you are stopping people tipping taxpayers into schemes.

Senator MILNE: So have you gone after any of the big four—PricewaterhouseCoopers, Ernst & Young, Deloittes, KPMG?

Mr Jordan: What I would say is that there have been examples where we have approached senior management of those firms and pointed out some behaviours—very isolated. It is not a usual or widespread thing.

Often they are unaware of the details of what has been going on, and they typically take decisive action as a result of our conversations with them. At that level, it is not the promoter sort of thing—at the big firm level. Sure, there are a lot of the grey areas and they are providing advice on a lot of the more complex international transfer pricing. It is really at the levels quite a lot lower—the smaller accounting practices and some of the small legal firms—that get into this very aggressive tax scheme stuff.

Mr Cranston: One comment about that: with the big four, we meet with them regularly, and the first question they ask us is: 'Is there anything you are seeing from our partners that you think is aggressive? Please let us know.' And we do follow it up. So they have their own strong governance around that aggressive—

Senator MILNE: 'So we can now avoid it and move on to the next thing'—I mean, clearly!

Senator EDWARDS: Mr Jordan, I want to get it on the record. I am going to give you a quote, and I would ask your opinion as to whether it varies from that. It comes from 24 January 2013:

> … I would have thought that everyone out there that was concerned about good public administration would see the common sense in observing what the Tax Office says about confidentiality provisions because they are important to every Australian and it's not a decision of the Government, it's the decision of the Tax Office.

CHAIR: Oh, my God. You have gone to the dirt file already—seriously. Someone in the Treasurer's office—is that where it came through from?

Senator EDWARDS: Would you agree that that is consistent with your position this morning? You have got your headline.

Mr Jordan: Is that my quote? Who said that?

Senator EDWARDS: That was attributed to—Lordy, Lordy—the Treasurer at the time, Wayne Swan.

Mr Jordan: I do not know what I can say there.

Senator EDWARDS: Is that consistent with your position?

CHAIR: You are asking him a question of opinion.

Mr Jordan: My position is that it is important, in the systemic sense, for us to be able to maintain confidentiality of taxpayer information. It is correct that, ultimately, it is our call—my call. Because of the responsible minister scenario, I cannot tell them the detail for them to make an independent judgement on maintaining that confidentiality. So, in the taxpayer scenario, it always does come back to the ATO, which is the ATO executive, the Second Commissioners, and myself—and ultimately, myself. So the principle of maintaining confidentiality of the information of taxpayers, I believe, is of a significant public interest that mostly outweighs the individual public interest of particular disclosures.

Senator EDWARDS: Look, I only bring it up because the chair has flagged that he is going to take it further. I think we are on very dangerous ground here. I think that the view of the current Treasurer and the former Treasurer would be consistent with the quote of 24 January 2013 by the former treasurer, Treasurer Wayne Swan.

This morning we heard from witnesses that somehow, through the redundancies that were offered recently through the ATO, you now have a lack of capacity, and it was inferred that you have got into bed with the big four—EY, KPMG, PricewaterhouseCoopers, and Deloittes—because you lack capacity. Would you like to make a comment on that?

Mr Jordan: Well, it is just not true. I would just deny that as in any way resembling any reality. Yes, we have had a program of redundancies. We had a target of 3,000; it is probably more like 3,500, or in excess of that, because there has been natural attrition as well as the voluntary redundancy program, and there is the freeze, more or less, on hiring other than without specific approval.

What we have done though is to make sure that we are allocating staff to the areas of the highest interest. We actually have something like 14 per cent more staff in the internationals area than we had three years ago. We have senior leaders, like Mark Konza, who I moved from being head of the Public Groups and International area, which is very large, to specifically building the team in internationals, which started out as a very small but expert group and has built up so that it is now a stand-alone group as internationals on its own, with an extremely experienced person. We have hired in 50 or so senior practitioners from the private sector: under that ISAPS program that I mentioned earlier, we got funding two budgets ago to have a look at these marketing hubs, and base erosion and profit-shifting. So we have got more senior people, we have got more private sector expertise brought in, and we have moved significant senior resources within the ATO into that internationals area, because that is really an area of our focus.

So I am satisfied at the level of resources. If we need more, we will shift more. We are totally de-layering management, we have to stop doing certain things that were just internal counting of stuff and reporting to ourselves, and we are focusing more on the actual client-facing, important issues.

Senator EDWARDS: All right. Do you outsource some of your work to those big four companies?

Mr Jordan: No, we don't. We do have a program that we have trialled that we are yet to make a decision on the future of—the ECAP, external compliance and assurance program. It is not the outsourcing of an audit. It does not seem to matter how many times I say that. It does not matter how many times we tell journalists that it is not an audit, it seems to be written up as that. It is simply the verification of certain factual matters in a much more efficient way and a much more timely way that we can often do it, because the external statutory auditors might have already looked at a large transaction. And they assure us that X did happen—rather than us asking for every email, letter, and correspondence and documents relating to X, and us having to go through it in a long way. We do not outsource our decision-making. We do not outsource our judgement. We do not outsource any of the underlying functions of the ATO. It is simply a choice of the taxpayer as to whether to use their external auditor, who might typically already have done that work, for the purposes of the statutory account.

Senator EDWARDS: The inference was that, with the redundancy program, you had sold your soul to the big four.

Mr Jordan: Obviously I strongly reject that. It is inappropriate, it is not based on fact and it is obviously trying to create some sort of atmosphere that this is just wrong.

Senator EDWARDS: In fact, in point 89 of your submission you say:

In early 2014 we recruited an additional 80 specialists …

So I presume that the redundancies were offered to people with skills that were not at that level and you have employed people appropriately qualified for the new regime which you are pursuing.

Mr Jordan: I obviously undersold myself when I said 50 or 60; it must be 80, if that is what is in the report. I should say as a general proposition, how do we go about identifying the people for the voluntary redundancies? We asked people for an expression of interest. They had to rate themselves on a one to three scale as to the criticality of their skills to the organisation and the criticality of their role to the organisation. Was the role that they are performing critical, with one being critical and three not being critical, and did they have skills that were specific and critical to the organisation, one being critical and three being not critical? Over 92 per cent of the people who had a voluntary redundancy approved were rated three and three. So they themselves rated their skills as not critical and their position not critical. That was then reviewed by their manager and then there was a senior panel of people from across different parts of the tax office that further reviewed that. When we look at the level of skills that were there, there were three levels: a self-assessment, a management review and a panel of senior people reviewing that the role was not critical and they did not bring particularly critical skills. The biggest complaints I still get from people about the voluntary redundancy program are from those who did not get one, but they were rated, either by themselves or by their manager, as having critical skills or the role they were performing was too critical to lose. There were about 400 or 500 people in that category who still want to go but we did not grant voluntary redundancies to them.

CHAIR: On that, Mr Jordan—and I know we have gone through this at Senate estimates, so I will not go through it again—

Mr Jordan: Let's do it again!

CHAIR: You cannot get enough of it!

Mr Jordan: We have half an hour we can spend on this, if you like.

CHAIR: I will place some questions on staff redundancies on notice.

Senator KETTER: I want to talk about offshore marketing hubs. Can you tell us whether the ATO has made any adverse assessments against firms for the abuse of offshore marketing hubs?

Mr Jordan: I will pass to Mark Konza who can talk more specifically on the status. As I have said, we are in dispute, clearly—we have mentioned that—with a number of taxpayers. He can talk about the stage we are at.

Mr Konza: The short answer is yes, we have made some adverse assessments with some taxpayers. We currently have 15 cases underway. That number fluctuates a little bit, depending on when cases are finished and started. There have been 20 in the past; there are 15 now. We have other cases to start and we are continuing to look at that issue.

Senator KETTER: Can you tell us which firms and for how much?

Mr Konza: We are not proposing to answer that question today because it would contravene their secrecy provisions.

Senator EDWARDS: Do you want to go through that again?

Mr Jordan: We can provide aggregated data. Under the ISAP, we have already raised assessments for in excess of $250 million. I presume part of that is from those.

Mr Konza: Yes, part of that is from that.

Mr Jordan: If you want to know the figures specifically for the marketing hubs, we could probably take that on notice and provide them.

Senator KETTER: I move to the proposed diverted profits tax. You might have heard Professor Vann talking briefly about that in the earlier session. What is your comment about that proposal?

Mr Jordan: Clearly that is a matter for government, as to whether they take any interim measures. I have said many times that the best long-term solution for everyone concerned, both taxpayers and us as revenue authorities, is to have some new, clear, international rules that all the major countries adopt domestically. Sometimes people ask how did we ever get into the situation that we are in, and I think part of that problem is that the current international tax architecture was designed by the League of Nations in the early 1920s. Clearly it is inappropriate, because the main focus is still around physical presence—a factory, workforce, warehouses, that sort of thing—and a growing part of our consumption has nothing to do with the physical presence in a particular country. It is all about services being delivered in a digital fashion, and the argument goes that intellectual property has a lot of value and that the server and that intellectual property could be located anywhere. Hence that aggressive structuring that we talked about earlier.

Senator KETTER: I understand your reluctance to give an opinion about that particular tax, coming back to the diverted profits tax. But is it possible that if that tax were imposed it could lead to instances of double taxation or contravene any of our tax treaty obligations?

Mr Jordan: As I said, the long-term solution is the new, clear set of international rules. Right now we are not sitting on our hands—we are testing a lot of the business structures and the assertions that are being made about no taxing rights here in Australia under existing law. We have the existing law that we are challenging things under; we have the more ideal, longer term scenario and, if government wishes to do something in the meantime then that is clearly a matter for them. Obviously they would take advice as to how it would be impacted by any double tax agreements. Obviously they would take advice as to how best to achieve that. In other words, would it be something in the general anti-avoidance provision part IVA specifically on this, or would it be another set of provisions in there? I would have thought that any decisions would be made in a way that did not contravene double tax agreements.

Senator KETTER: How would it operate alongside those tax treaty obligations?

Mr Jordan: If I could talk about the UK scenario, it is saying that there are certain domestic treatments of the operations of particular countries. Then it would be up to the two countries in the double tax agreement to see if there was any dispute on that. Simply, it is saying that your profits in this particular country are calculated in a different way. The existing treaties talk about the profits of an enterprise and, as I understand, the UK model is trying to identify what that word 'profits' means under the treaty. There may well be some disputes with some countries but, again, I presume—I do not know—that the UK has taken advice on this.

Mr Konza: Rather than saying that things contravene treaties, I would characterise things as being supported or not supported by treaties. Treaties are there to avoid double taxation. The criticism in the UK of their diverted profits tax is that the way it is characterised is not covered by their double tax agreements, so companies that get a diverted profits tax bill would not have a right under the treaty to seek relief in the other country. But that is a characteristic of the way the British diverted profits tax has been constructed, and it is a matter that each country looking at its legislative program thinks about in relation to the effect on treaties.

Mr Mills: I think the interesting thing to remember about their diverted profits tax, as Richard Vann pointed out, is that it was designed to raise no revenue. It was actually designed to force people into the corporate tax regime.

Senator KETTER: Have you given any thought to how much it might raise in Australia?

Mr Mills: Not at this stage.

Mr Jordan: I think it is a similar scenario—that if you have provisions that force people back into the main system, that is a good result. We have not done any calculations that I am aware of as to any potential revenue on that front. Sometimes putting obstacles in people's way does drive behaviour, so from our point of view perhaps

the more obstacles in the way for people to achieve a result is a good thing. In other words, that obstacle might then push them back into the mainstream tax system.

Senator KETTER: I would like to go back to the adverse assessments that we talked about a bit earlier. You talked about providing the aggregated figures. Are you able to provide information about the individual sizes of the disputed amounts?

Mr Konza: We would normally desist from doing that because they might be—not only do we try not to disclose taxpayers' identities and their personal information but also we try not to disclose information that can be readily tracked to a taxpayer. If we break that sort of detail down people will go to public disclosures or provisions. This sort of analysis, I read in the press, is already undertaken. We resist doing that, if we can.

Mr Jordan: Why don't I undertake that we will have a look at those figures and see if, if we break it down, it would be very obvious as to who it was or not and we will make a judgement? If we can, we will provide it broken down into individuals.

Senator KETTER: Have any of those taxpayers prepaid any amounts?

Mr Konza: By assessment, I took into account cases where we have settled the audit with a tax being paid so, yes, that tax has been paid.

Senator KETTER: Can you provide us with information about that as well?

Mr Konza: Yes.

Senator KETTER: Even if you could tell us which industries are involved as well, that would be helpful.

Mr Konza: Yes.

Mr Cranston: In our debt-collection policies, if there is a dispute, they can pay 50 per cent. So there is a prepayment situation before the dispute is resolved. What they get is a concession on the interest charged on the remaining amount. That is probably what you are talking about: prepaid.

Senator KETTER: Yes, that is right; thank you. I would like to revisit the most recent round of funding cuts. In terms of compliance staff within the ATO, how many of those were impacted?

Mr Cranston: In relation to the compliance staff, let me first talk about the front-line staff around audit. There is a net of about 350 auditors out of—we have gone from 5,000 auditors across the whole of compliance, which includes work from individual taxpayers, cash economy, all the way to large businesses. There has been a reduction of 350 of those front-line staff. The reason there is a difference between who left—there are potentially 500 of those—and the 350 is that we brought in some of those people from outside, those technical specialists of 80. We have had some graduates who generally went to that area, plus we were able to get people who had skill sets from the past working in some of the other areas, which was not working in the audit area, that we could bring back. That is why there has only been a net reduction of that.

Senator KETTER: How many were lost from the multinational tax division?

Mr Cranston: There are about 900 staff working on front-line audit work plus risk work, and there are about 150 people doing advice work. The amount of that 340 in relation to the multinational area is down a little compared to what it was in the past but, from where we were three years ago, it is significantly up—I think it was 14 per cent. When we saw some concerns around our multinational work we went to government and we have what we call the ISAPS funding. It was over two tranches of funding, and we got $240 million over four years to do some work there. That would then go to staff. That is why there is an increase.

Mr Konza: We need to step back a little bit because this will get very confusing, particularly as you get other evidence. We operate a part of the business called Public Groups and International. Mr Hirschhorn is the Deputy Commissioner of Public Groups. I am the Deputy Commissioner of International and we work in partnership in charge of that one area. There are 153 people in the international part and there are about 1,100 and something people in the public groups part. The international part is actually 20 people more than it was two years ago; the public groups part is about 150 less than it was two years ago. The international people, we do various specialist things, but a lot of what we do is assist operational teams in Mr Hirschhorn's area that carry out the audits and provide the rulings, do the APAs and monitor individual taxpayers.

How have we coped with a reduction in the number of people in that area in the way that the commissioner spoke of an hour ago? We have flattened structures, we have consolidated our teams so that we are more efficient, we have changed our processes. All in all, we have improved the management of our processes so that we can stay as effective as we were.

Senator KETTER: Well you have had to cope with the situation; being efficient is something you could have done without the benefit of funding cuts to spur you along with that. But if you were given additional resources, how would those best be used?

Mr Jordan: From our point of view, we are doing a lot of work in our analytics area because we think that has got a huge leverage potential. They are highly specialised people: they are typically not with a tax background, but a lot of engineering, computer science, software development backgrounds. That is a very strong focus. We call that project 'smarter data'. It is one of the six strategic programs we have under our reinventing the ATO banner—it is very, very important to us; in the next five years this will be critical—so some investment in there would be very useful to us.

In the financial crime area, the really hard end of evasion, Project Wickenby funding is coming to an end at 30 June this year. We would like to see some wider form of serious financial crime collaboration continue. Wickenby was to do with certain tax havens and the funnelling of money to tax havens. A lot of people think we automatically can exchange information with other agencies. We cannot. It is only if there is a specified task force, I think under the Australian Crime Commission Act, that we can actually exchange information with bodies like the Australian Crime Commission, the Australian Federal Police, ASIC et cetera. Wickenby has been a great example of how cross-agency collaboration can produce good results. With that finishing, I think some investment to make sure we can continue to have sharing of information in the serious crime area and the evasion area amongst ASIC, Australian Federal Police, Customs and Border Protection, AUSTRAC and the Australian Crime Commission would be really good; there would be a worthwhile return there. And, depending on how we go, maybe a little bit more expertise in the transfer pricing area. We have recruited heavily there, but I suppose more would always be good in that specific area. They are the ones that come to my mind.

Senator KETTER: I remember you telling us at estimates that some of the investment that you put into some of the major companies was returning quite a lot of revenue, that it was a very worthwhile investment you were making. Can you tell us what the potential revenue implications would be of increasing ATO funding?

Mr Jordan: That is a very difficult question because it is not linear. Some people divide the revenue we collect by the number of employees, and say that if you get more employees, there is a bigger multiple. I wish it was that easy, but I think, as I said, the better use of analytics, the better quality of risk profiling and the better direction of our resources to those where we think there is a problem and all we are trying to do is to quantify it.

To come back to the other senator's father's problem about fearing, I have had small business people say, 'I lie awake at night having nightmares about the tax office coming in to audit me'. My response is, 'What do you do that worries you so much?' They say, 'I just fear I'm making a mistake and I could have a problem'. What we are trying to do just take that issue away from people is to make sure that our data matching, our analytical ability, our risk engines are so good that we are not spitting out people unnecessarily. With those who come out of the system, we pretty well know there is a major issue. Some people in the small business area like to claim deductions for all of their outgoings but they do not like to show all of their sales. They do not realise how easy it is for us to line that up against the benchmark and say: 'You are way out of line here with everyone else. We just want to see what is going on. Are you just a bad businessperson or are you not disclosing your sales?'

So it is not really an overall bucket that you put money into; it is particular initiatives that we want to put to government. As I said, our desire would be to have a bit more in the analytics area and a bit more in the serious financial crime evasion area. We find that area is challenged all the time. One case came out at the end of last year where there had been 40 challenges to us. It took five or six years. You talk about how long these things take. It is often not us who is dragging the chain; it is just these legal challenges. We have to work out with the courts a quicker way of getting things up and how we prioritise things we need to get out there. I think that is a big thing. It is taking a slice of our operations and putting a proposal to government for funding in that area rather than just saying: 'We are a big bucket and more money will get thrown in.' It is really more in that stratified area.

Mr Cranston: Under Chris Jordan's leadership one of the big things he is pushing is to improve the client experience. In saying that, most taxpayers do the right thing. One thing following from that is do not audit taxpayers who are doing the right thing. It could not get worse than that. When we look at our compliance work, as you said, how much more can we get out of it? It is very hard to squeeze blood out of a stone, because taxpayers are doing the right thing. What we do is focus on high-risk work. When there is a situation we think is high-risk work and we do not have enough resources to provide assurance across that through meeting with them, engaging with them, audits et cetera generally we will go back to government and ask for more resources to deal with that. One good example would be some of the work in Mr Konza's area. He is focusing very much on the ISAPS work, very much on marketing hubs et cetera. It is very early stages because it takes years to get behind

some of this. If there is a situation where we feel that we need to go back to government because the risks outweigh the resourcing, we would do that.

Senator KETTER: I want to revisit the conversation about the big four accounting firms, particularly in respect of their activities in Luxembourg and other places that we talked about. Do you have some concerns about the ATO allowing those firms to vouch for audit information as part of the ECAP program you talked about?

Mr Jordan: No, because they are not vouching for audits. ECAP is not an audit. We are not outsourcing our judgement, we are not outsourcing any of our decision-making processes and ECAP is not an audit. I feel I have to keep saying that because it just keeps coming back that we are outsourcing audits. We are not outsourcing audits. ECAP is not an audit.

Senator EDWARDS: What is it again?

Mr Jordan: It is not an audit. It was a pilot. We are in the process of evaluating it. We did parallel things between the results of about 20 ECAPs and about 20 similar things over here to see what is happening. Interestingly, it appears we got more money out of those with ECAP than we did on the other side. Places like Singapore go further. They actually do outsource the audit in GST. I asked the Singaporean commissioner what he thought about this and he said, 'We love it because they are harder than us and they are faster than us. They know where to go.' We are not looking at outsourcing audits. I am not saying we are going to follow Singapore—can I just make that clear: we are not going to follow the Singapore situation. But that was their response. They said: 'They know where to go. They are quicker and they are harder than us.' We do not feel there is any conflict because statutory auditors are under a fiduciary duty to act honestly and they just will not make things up. They just do not do that.

Senator KETTER: Putting to one side that you say it is not an audit—and I accept what you say; I have heard you say that before—there are evaluation processes going on as part of this pilot and we have some concerns about the behaviour of those big four companies in other places. That is the heart of my question.

Mr Jordan: Maybe the time is not right for an ECAP program. It is something we think is good and it is something that we think is efficient, but perhaps the timing in the community is just not right for it.

CHAIR: We are going to go to Senator Xenophon. We are going to be running a little bit over. If you do not mind, we will be running a few minutes over.

Senator XENOPHON: Mr Jordan, I have got four distinct areas I want to ask you questions on. I will race through them, because time is limited. Could I go to where we were 84 minutes ago, and that was in respect of the line of questioning that the chair asked you in respect of the public interest immunity issues and about these individual companies. I understand that you say you cannot name them because of the strict privacy provisions in the tax act, but can you tell us whether the tax office has estimated how much potential tax is involved for the 69 target companies if we had, for instance, a broad multilateral agreement in relation to tax, how much extra tax could potentially be paid. I know you can only give a ballpark figure but if we can get an idea of that it would be very useful.

Mr Jordan: I will need to pass on to my colleagues but I think in terms of the marketing hubs we have estimated there is about $1 billion there that—

Senator XENOPHON: In annual revenue?

Mr Jordan: Yes. Revenue to date might cover a couple of years. I should pass to my colleagues who know more—

CHAIR: Could I ask for a point of clarification on the figure, if you are talking about whether that would be not taxable revenue but actual—

Mr Jordan: Tax. We will talk tax.

Senator XENOPHON: I just want to put this in context. You told Fairfax Media a week ago today that the tax office will beat a budget target of hitting $1.1 billion in revenue from multinationals by 2017 and possibly in the next 12 months.

Mr Jordan: That is under the ISAPS program itself. When we heard, I think it was, the figure of $240 million we were given over a four-year period, we committed to government to raise $1.1 billion in return for the investment of $240 million. We believe we will easily exceed that $1.1 billion. We have already raised $250 million of that, either through settlements or assessments.

Senator XENOPHON: But the specific question is: in terms of the argument over the public interest immunity and confidentiality, there are 69 target companies; surely the tax office has looked at potentially how

much tax the Commonwealth government is missing out on in respect of that. Can you tell us what that range of figures is?

Mr Jordan: I will pass to Mr Konza, but I should say that some of the companies that get mentioned in this area are not part of the 69, because they do not disclose revenue in Australia of $5 billion. They tend to be more the Australian listed companies with that amount. They sit in the next 300 companies that constitute about 24 per cent of the tax base. We believe there is a substantial upside in revenue there. I think it is difficult to put a figure on it but I will pass over to my colleague.

Senator XENOPHON: Okay. Sorry, I just want to get a specific answer. I appreciate you are being very helpful. These are 69 companies that were subject to this public interest immunity argument. There are another 300 companies that have significant revenue. What I am trying to establish for the purpose of this inquiry is: if we had a tighter set of arrangements in terms of tax arrangements, how much more would that mean potentially—even in a range of figures—for the Commonwealth of Australia, in terms of what we could be getting back in additional taxes. Surely you must have a ballpark figure in mind. Or do you? Is there a ballpark figure?

Mr Cranston: We are trying to work on the tax cap. Only four countries around the world have published a tax cap. One of our priorities for the tax cap, for us this year, is the large market. We are currently sort of estimating it, but it has got to be a credible estimate and we have got a number of experts who are giving us feedback and saying we are missing certain areas. Until we get that right it is very dangerous to put an estimate on it.

Senator XENOPHON: Okay. So not even an estimate at this stage.

Mr Cranston: Not even an estimate. We are planning to have an estimate—

Senator XENOPHON: So no credible estimates; not even an incredible estimate?

Mr Mills: Senator, inherent in your question is whether or not the law needs to change in order to capture some of that, as opposed to that part of it that we assess we can challenge, within existing law—

Senator XENOPHON: Thank you for clarifying that, Mr Mills. So I guess my question is: surely the tax office would give advice to the government in consultation with Treasury from time to time as to whether there are particular gaps that should be closed. Has the tax office given advice to the government of gaps that ought to be closed, as you have just indicated? If so, what is the ballpark figure of additional revenue for the Commonwealth?

Mr Mills: A lot of this actually comes under the BEPS work that is being done—part of the multilateral work that is being done. So it is tied up in that broader package of things. I do not recall, although I can take it on notice and find out, that there are exact figures because they actually relate to a whole range of different initiatives.

Senator XENOPHON: So not even around the coffee machine or the water cooler does the tax office have an idea of how much money could potentially be gathered by the Commonwealth if the laws are tightened up?

Mr Mills: It depends. You have to assume what the outcome of that change in law will be. So it depends on the exact initiative before you can actually make the estimate. It is impossible to say—

Senator XENOPHON: Have there been any estimates made under any scenarios as to additional revenue for the Commonwealth?

Mr Konza: You have to ask Treasury those questions. We look at cases—

Senator XENOPHON: But you can advise Treasury.

Mr Konza: We advise Treasury about what we see in particular cases and then Treasury decide whether they are going to change the law or how they want to change the law. They will ask us for data to support their decision-making process.

Senator XENOPHON: So no-one here can give me a ballpark figure of additional revenue that the Commonwealth could get if we tightened up these multinational tax arrangements? Can anyone tell me? Nothing.

Mr Konza: Are you talking about the entire BEPS agenda?

Senator XENOPHON: If the BEPS agenda was implemented, for instance, use that as an assumption, what would that mean in terms of additional taxes for the Commonwealth?

Mr Konza: You are asking a question where we do not know what the result of the tightening of the agenda would be, so we cannot postulate a figure.

Senator XENOPHON: But there have not been any scenarios considered by tax in respect of this?

Mr Konza: You would have to ask Treasury about the advice.

Senator XENOPHON: Let me go to an article that you were quite extensively quoted in. I think I asked you about this in Senate estimates last June. In the *Financial Review* article on 21 May 2014 by Nassim Khadem, headed 'Profit shifting not just a tech problem', I think you made the fair enough point that it is not just about high-tech companies. The figures in that table, which I think were endorsed by the tax office or from the tax office, were that in 2011-12 $130.62 billion was sent from Australian companies in terms of their international expenditure, including $39.99 billion in Singapore alone. There was an interchange with Mr Jordan about Starbucks and their intellectual property and I think I got you on the record referring to Starbucks's arrangements with some element of sarcasm. What has happened with respect to that? We are not just talking about high-tech companies, Google and Apple. It was $130 billion three financial years ago. What is it this year or what was the figure last financial year?

Mr Konza: We have a schedule called the international dealing schedule, which large companies have to fill out. As part of that, they have to advise us of the top 3 countries where they send and receive international related party payments. It is a two-way thing. Last year's schedule said that there was, I think, $322 billion—

Senator XENOPHON: So it has gone from $130 billion to $322 billion?

Mr Konza: Yes.

Mr Hirschhorn: That is both sides—both purchases and sales. I think the $130 billion might be just one side.

Senator XENOPHON: Expenditure. So what would expenditure be? How much has that gone up?

Mr Konza: I would need to take that on notice.

Senator XENOPHON: But it has gone up—hasn't it?

Mr Konza: Yes.

Senator XENOPHON: So we might up towards $200 billion?

Mr Konza: I would not want to speculate.

Senator XENOPHON: Professor Richard Vann made reference to section 23AJ of the Income Tax Assessment Act being repealed. After it was introduced into parliament on 17 July 2014, it has been rewritten as subdivision 768-A of the act. I have just read a KPMG circular this morning which states:

> 768-A will, however, provide opportunities for taxpayers as it will extend the exemption to a broader range of equity interests (e.g. non-share dividends) … this change is welcomed …

This is something that breezed through parliament. I will put my hand up—it was an issue without any controversy. It was actually a measure of the former Gillard government and implemented by the Abbott government. I am not criticising anyone; I am just saying it breezed through the parliament. Can you, on notice, provide me with information as to whether that measure in relation to international dividends and other equities has meant we are now collecting less tax rather than more from these sorts of transactions? That was the imputation of what Professor Vann was saying. We have done something that has made us go backwards. It is not a criticism.

Mr Mills: Can I put it in context. The reason successive governments have gone down this path is that we made a decision about 10 or 15 years ago to set up a set of in-substance debt and equity rules. Those changes that were most recently done were consistent with those in-substance debt and equity rules. What we have done is gone down a path that maintains a consistency. The alternative was to do what Professor Vann referred to as the European solution, if you like, which would have been completely inconsistent and would have created the potential for gaps. The rules have only just been implemented in respect of I think the current year, which means that we have no data as yet.

Senator XENOPHON: But, from Professor Vann's evidence, it is likely that, under the old section 23AJ, we would have collected more tax from these international transactions, but now we will be collecting less, which seems to go against the grain of what we are concerned about.

Mr Mills: Section 23AJ was an exempting provision and what it did is actually one of the problems. As it previously existed, it was granting exemptions for things that were effectively debt instruments, not equity instruments. We have swapped it so that it is consistent with our broad range of things.

Senator XENOPHON: But the exemptions are now broader. Is that right?

Mr Mills: Well, it has taken a completely different turn.

Senator XENOPHON: Are the exemptions now broader?

Mr Mills: You cannot say it is broader. It is a different way of looking at it. Parliament—you—have decided that it needs to be done consistent with the rest of the law that we have underlying it. Whether or not that is the ultimate solution—

Senator XENOPHON: But the question is: are we going to get less or more tax from overseas transactions?

Mr Mills: We will take that on notice, as you requested.

Senator XENOPHON: Thank you, Chair.

Senator MILNE: Did you provide advice, as the tax office, to Treasury or the parliament about the likely implications of this law being changed? In light of the fact that obviously a tax academic has told us that it creates a greater opportunity for tax avoidance, did you point that out and was that part of the consideration? It certainly was not something that came to the parliament, which comes back to my point about advising Treasury as opposed to advising the parliament. Take it on notice if you do not know, but did you provide written evidence to Treasury in relation to this and, if so, will you provide it?

Mr Mills: We will take it on notice.

Mr Jordan: I am happy to have a look at this whole thing, because, from my recollection what the amendments were trying to do was to stop people that were creating some restructures that allowed deductions in overseas countries but an exempt dividend here. There was an anomaly in the definition of section 23AJ that was designed to say if, in substance, it is debt, it will be treated as debt and therefore will be taxable here, because you have got a deduction over there. And if, in substance, it was equity, it would stop a lot of these artificial arrangements between countries that were getting deductions overseas and here. I am a little surprised, I suppose, to hear this come out this morning and I am happy to have us look at this—

Senator XENOPHON: It arose out of Professor Vann's evidence.

Mr Jordan: Yes, that is what I mean. I am happy to undertake to look at that within the ATO and to perhaps provide advice to Treasury. My understanding was that it was designed to stop people structuring things to get an exempt dividend when it was really interest that should be taxable.

Senator XENOPHON: KPMG was quite excited about it though.

Mr Jordan: I will take that on board, and thank you for pointing it out.

Senator CANAVAN: At the outset, I would like to put on record that I have only been a member of this committee for eight or nine months. I have been a regular observer of economics committees and I have regularly seen witnesses from the ATO not reveal individual taxpayers' details. From my experience, at least, that has always been accepted by this committee. Indeed, it is not just the ATO witnesses; it is often the ACCC as well. Mr Jordan has already outlined how revealing that might undermine our tax system. But I would also like to put on record that, if we go down the path you have outlined, it has the potential to undermine the work of this committee, because we seem to be focusing on something which is rather fruitless—

CHAIR: Hang on.

Senator CANAVAN: Chair, I did not interrupt you—

CHAIR: Well, that is not a question.

Senator CANAVAN: Well, I can make a point of order—

CHAIR: You got your talking points from the Treasurer's office, obviously.

Senator CANAVAN: I can make a point of order if you like. Chair, I want to put on record that we have received very useful evidence this morning. There are clearly issues with the system that should be discussed and debated. But to go down the path where we would overturn probably years of this committee's experience in demanding that individual taxpayers, who are under investigation but have not been charged, be identified would be a regrettable step and undermine the effectiveness and credibility of this committee. It is not a course I would support.

To flesh out this issue, I want to ask the ATO about its FOI disclosure log, which goes back to 2011. I have looked at it and I can see four cases, other than the case we have been discussing today, where you have invoked section 38 for taxpayer confidentiality reasons. There may be some others there. Can you on notice go back whether there have been other cases where you have invoked taxpayer confidentiality? Some of those past cases go to the quote from Mr Swan that Senator Edwards used and that referred to the Minerals Resource Rent Tax. Clearly there was a reason the government did not want to reveal. That instance was not about identifying taxpayers directly; it was rather a question about whether a taxpayer could be indirectly identified. If you could give me all those cases, it would be greatly appreciated.

Mr Jordan: We will take that on notice, Senator. I should have also mentioned earlier that we will obviously be monitoring these proceedings and I have suggested to you that you ask corporates specifically about their own information. If it comes to our attention that there is information, which we do not believe is correct or is misleading, we are willing to inform the committee that in our view something was incorrect. My advice, as previously given, is that, whilst we cannot give information about taxpayers, if they themselves make statements publicly that we know to be incorrect, we are within our rights—not breaching the secrecy provisions—to correct the public record. So we will certainly make that undertaking to you: if information is stated to this committee that we understand is incorrect in their tax affairs, we will correct the record.

Senator CANAVAN: That is appreciated, Mr Jordan. I want to move onto a different topic. Earlier this morning we discussed the Tax Justice Network report. Has the ATO looked at that report?

Mr Jordan: We have looked at that report in detail and we have fundamental issues with it, because it compares apples and oranges in looking at some of those effective tax rates. It does include property trusts; it includes superannuation funds. There are a number of reasons the effective tax rate may be different from a headline rate on accounting profit. We do have a system that exempts income from active foreign operations from any further Australian tax. There are incentives for R&D, and we have done a little bit of work in trying to build from what it says up to the 30 per cent rate. If you wanted, we could go through that in a little more detail, but we have some fundamental issues with throwing all these large organisations in together and making broad assertions around it. We are much more focused on the individual activities of individual companies and making sure, as I said, that we have total surveillance of those 69 big entities.

Mr Mills: The headline difference between the 30 and the 19 that has been quoted in various places, about half the gap—around six of the 11 per cent—is attributable to the superannuation fund number that is included—

Mr Jordan: Which are taxed at 15 per cent.

Mr Mills: which are taxed at 15 instead of 30. About 20 per cent of that gap—let's say two per cent of the 11 per cent is attributable to trusts included in the numbers. Of course, in the trust situations the investor gets taxed rather than the entity. The balance is attributable to things like franking offsets, which avoid double taxation, where dividends flow between companies. It is also the R&D that the commissioner mentioned and other small things like that. So the amounts are reconcilable by reference, effectively, to the way the system is. It is a matter of making sure, I guess, that the data that is being used is being used responsibly.

Senator CANAVAN: That is very useful. I have got an interest in the court processes and their costliness, and you have already touched a little bit on that in some of the evidence. In your submission you raised an issue where there were 12 expert opinions and, Mr Jordan, you mentioned there was one case where there were 30 expert opinions. Do you have ballpark figures for us on what sort of costs and what sort of time frame you look at when you are assessing whether to take a case or to challenge it?

Mr Jordan: Debbie Hastings is here and has not had the opportunity to speak yet. She heads up our review area.

Ms Hastings: Large corporates comprise a relatively small amount of our litigation. Regarding the litigation that is lodged, I noticed in the hearing earlier this morning you were asking whether it goes to a tribunal or whether it goes to the court. Appeals can go either to the Administrative Appeals Tribunal or straight to the Federal Court. Overwhelmingly, the bulk, the great majority of all of appeals go to the tribunal, and most of those appeals—

Senator CANAVAN: That is at the request of the taxpayers, is it?

Ms Hastings: That is right. The taxpayer lodges the appeal, and overwhelmingly the majority of appeals are lodged by individuals or very small businesses. Large corporates tend to go to the Federal Court and start there with their cases. In terms of how long the process takes, the Federal Court rules were amended a few years ago to streamline the process. Once we are at the point where the taxpayer lodges an appeal in the Federal Court, both sides are deemed to be ready to proceed to the hearing and the court moves through quickly through the process. So we can get to a hearing well within the 12 months of an appeal being lodged.

Senator CANAVAN: It gets to the hearing, but is it resolved.

Ms Hastings: It can be at the hearing and resolved, such as a decision being handed down by the court, within 12 months.

Senator CANAVAN: What sort of budget would you be thinking of? I suppose it would depend on the case, but is there a ballpark figure you work on?

Ms Hastings: No, there is not. It does depend on the complexity of the case. The one that Chris mentioned earlier was extremely complex in terms of the issues and the evidence and the amount of experts. That case required a number of barristers. Most cases that go to the Federal Court would generally have one senior counsel and one junior barrister. In terms of external expenditure last year—so, to law firms or to barristers—we have spent approximately $28 million. But that was for all of our litigation.

Senator CANAVAN: Mr Jordan, this is probably more a question for you. Is the cost of legal action a relevant consideration when you are thinking about how you are going to enforce or take compliance action?

Mr Jordan: It depends on the particular circumstances. If you have got a very small item in dispute with a small business person, we have got to start to make better judgement.

Senator CANAVAN: That is a very good point. I will just restrict my question to these large corporates we have been largely talking about today, where very large sums of money are at stake.

Mr Jordan: Regarding the large corporates, it depends again on the point we are trying to make by going to litigation. Sometimes we want to signal to the market that particular behaviour is unacceptable. So we will not settle and we will take that to court, and at times it costs a lot of money to do that. Clearly, in any decision-making processes, we will weigh up the costs and the benefit. We are not going always be spending more then we are going to raise, unless it is a serious point of principle that we need to have on the record. Regarding some of these cases, Ms Hastings talked about how quickly some things can happen. The reverse of that is that it can take years, and in one case that I mentioned there were 40 procedural challenges that just cost a lot of money. That was a particular promoter of the scheme and there was $350 million of tax at stake across a number of clients of that particular accounting firm. That was worth taking on. That was very egregious behaviour. The costs of doing these things are high. That is why we want to move to a greater proportion of alternative dispute resolution processes. At the very large and complex level it might be a retired Federal Court or High Court judge. It is still relatively formal, but you are not bound by all the rules of proceedings and that sort of thing. With the small businesses, we have a lot of trained facilitators—

Senator CANAVAN: I have limited time. Are there any legislative or regulatory changes needed to go down that alternative dispute resolution route or can you do that yourselves?

Mr Jordan: I think we are fine on that front.

CHAIR: We have one or two final follow-on questions from Senator Milne.

Senator MILNE: This afternoon, one of our witnesses is Google, so I would very much like to know how the tax office treats its own arrangements with Google? Could you confirm for a start that the tax office pays Google for services for a website and/or advertising or any other services or goods that Google may provide the tax office?

Mr Jordan: I am not sure we have any advertising—because people sort of know us—but I presume we have commercial arrangements. I know Google is on my computer at work, so I presume we pay for that and use their search functions. We would have iPhones with Apple and we use Apple products and we use Google.

CHAIR: Mr Jordan, I hope you are not paying for searching and browsing?

Mr Jordan: I do not know. We do not advertise. I am pretty sure we do not advertise.

Senator MILNE: To whom does the tax office pay, then? Do you pay an entity in Australia or do you believe you are paying an entity in the United States or somewhere else for the services that Google provides the tax office, whatever they might be?

Mr Jordan: I do not know the answer regarding Google. I am pretty sure that we pay to Apple Australia, which is a subsidiary of theirs. Does anyone else know what we do?

Mr Cranston: I would not think we pay Google anything. We do not advertise and the web service is free. But for Apple, yes.

Senator MILNE: Let me switch to Apple, then. It is the same question. It is not particular about a company; it is more the issue: to which entity do you actually pay it—an Australian entity or do you believe that the service is being paid for to an entity in the United States or somewhere else? How does this relate to withholding tax? Tell me, first of all, how many experts do you have in the tax office on withholding tax now?

Mr Jordan: With Apple—if I could just deal with that one and I will pass to Mark Konza on the withholding tax—I understand that for our product we pay Apple Australia Pty Ltd, which is a subsidiary of international Apple. They disclose the sales of that here in Australia. In terms of withholding tax—

Mr Konza: I could not put a number on that. We have a number of people who are experts on withholding tax. What you might be driving at is that there was a former officer saying that he only did withholding tax and was a withholding tax expert, and he expressed concern about our coverage of the topic of withholding tax. I would just like to say that there is something of a fundamental difference in that thought and my approach to the administration of international tax. A number of years ago when I moved into the Public Groups area, I discovered that a range of people concentrated on one particular aspect of international taxation. My concern is that if you do that you get outmanoeuvred by people who are using a multifaceted approach to profit shifting. Transfer pricing is only one part of profit shifting. We have, for probably the last five years, been emphasising that we expect our officers to be able to handle all the major components of profit shifting. When you are looking at transfer pricing, what goes into the products that are being priced also goes to the question of withholding taxes. We expect our international tax experts to be able to cover withholding tax.

Senator MILNE: I understand this is the end, so please put it on notice. You also have an arrangement, I understand, with Oracle Siebel to provide a service. Would you take on notice, please, any arrangements the tax office has with a particular company that is based overseas and may have a subsidiary here, to whom you actually pay, and the tax arrangements, accordingly? Thank you.

Mr Cranston: In case I have misled the committee, in relation to Google, our understanding is the search engine is embedded in our web pages. I do not know what that means in payments, so we will also take that on notice.

Mr Jordan: You are very well informed about Siebel. It is an interesting product that some people love and some people do not, in our organisation, our client-relationship management product.

CHAIR: I want to thank the commission. I think we have done a couple of hours straight—which are enhanced interrogation techniques, I think they call them internationally! Mr Jordan, you could take this on notice. I wrote you a letter asking a whole bunch of information, which I assume will take a little while to get together, some of which will be more appropriate, I know, for Treasury. It is in regard to the superannuation tax concessions. We have not had an opportunity to get to that today but if you could take that on notice, providing the information, some of which I know is quite—I know some of the information would be more appropriately asked of the revenue group, and I will be asking them tomorrow.

Mr Jordan: I can assure you that we have already got people on the case. We received that yesterday afternoon and we have people working on that. We will get that to you as soon as possible.

CHAIR: I want to again thank the Australian Taxation Office for their participation in this inquiry. It is an ongoing inquiry. We may come to you again, particularly in writing, for different questions and information. We may ask to see you again, but we do have a regular opportunity to have you before us through the Senate estimates process, and we always appreciate your participation. Thank you, Mr Jordan. The committee will now break. We will return with representatives from Google, Apple and Microsoft.

Proceedings suspended from 12:56 to 13:44

CARNEGIE, Ms Maile, Managing Director, Google Australia

KING, Mr Tony, Managing Director, Australia and New Zealand, Apple Pty Ltd

SAMPLE, Mr Bill, Corporate Vice-President, Worldwide Tax, Microsoft Corporation

CHAIR: I welcome Mr Tony King from Apple, Ms Maile Carnegie from Google and Mr Bill Sample from the Microsoft Corporation. I thank you all for participating in this inquiry. I believe two of you have made submissions. Thank you for that. I want to point out that, since the committee first made contact with your three companies, you have been incredibly willing to participate in any questioning we have. I know some of you have had to change travel and other arrangements to be able to be here today. We as a committee very much appreciate that. Committee members will obviously have a fair few questions for you. Before we get to that though I want to give you the opportunity to say a few brief opening remarks—please, I stress, 'brief'. That will be fantastic because I know there will be a lot of questions and perhaps what you are prepared to say in your opening remarks will get covered in questions anyway.

Mr King: Good afternoon, Chair and Senators. I am proud to represent Apple Australia here today. Apple have been operating in Australia for more than 30 years and we now employ over 2,000 people here. We also have 21 Apple retail stores across the country where we serve tens of thousands of customers every week. Our business model is simple: we sell and distribute the best products in the world to our customers here.

Apple Australia pays all taxes it owes in accordance with Australian law. Apple's product design, development and manufacturing all take place outside of Australia. All of the sales from our operations are included in Apple Australia's accounts. Apple Australia buys the products we sell here and we pay Australian tax on the profit on these sales. We also pay GST on every single sale in addition to corporate, payroll and fringe benefits tax. In fact, in our most recently lodged accounts our effective tax rate was above the Australian corporate tax rate of 30 per cent.

In addition to our Apple retail stores, we have a broad network of partners who are successfully selling our products to millions of customers around the country. Our reseller channel alone offers more than 6,500 places for our customers to buy and this has driven hundreds of more local jobs. Apple's introduction of the App Store created an entirely new industry. We have over 270,000 registered app developers in Australia, who have earned over $268 million. Many of these developers are individuals or small businesses, some of whom have grown to employ over 100 people and are competing head to head with the biggest names in the global software industry.

We also believe in leaving the world a better place. One example of how we put that into action here is by running all of our offices and retail stores around Australia on renewable energy.

We are committed to Australia's economy and its success. We are transparent and open with the Australian tax office and have worked through its advance pricing agreement program since its inception to determine how to confirm the prices on the products we buy from affiliates outside of Australia. Just as countless other Australian taxpayers have, Apple Australia sought these agreements as part of a formal and globally recognised program to assure certainty on compliance with all relevant Australian laws. These agreements are reviewed regularly in line with normal tax office procedures to ensure Apple Australia is in compliance with all of its Australian tax obligations. The ATO has confirmed on a number of occasions that we have a cooperative relationship and we remain willing to enter into further agreements in line with normal business practice here in Australia.

We are proud of our long history in Australia and the many contributions we make here. We look forward to continuing to serve our customers around the country. I would be happy to answer your questions.

Ms Carnegie: Thank you for inviting me here today. The way multinationals operate, particularly in terms of how we operate with tax, is an issue which is in a lot of conversation globally but also, as you know, in Australia. And a question that I get asked by friends, family and also my customers is: 'If Google generates a lot of revenue here, and they have a sales force which is based in Australia that helps to deliver that revenue, why does Google not pay more corporation tax in Australia?' Now before I answer that question, I thought that it might be helpful if I provided a little bit of context on Google globally but also on what we actually do on the ground in Australia.

Google is now a global company. We have operations in about 70 offices, both in terms of sales and R&D, across 40 different countries. Our users and customers come from all around the world. Google's global corporate tax rate is just over 19 per cent, and we incurred taxes of $3.3 billion last year. Almost all of those taxes were paid in the United States by our headquarters, Google Inc. In Australia, Google employs about 1,000 people and we perform two very important functions for Google globally. The first one is that we provide sales and marketing support services. What that means is that people on the ground in Australia help to explain our very new-to-the-world services, including advertising services, both to users but also to businesses. Because the services are new

to the world, users often require a lot of education in terms of what they are, why you should use them, how you should use them, and when you should use them; and we provide a lot of education. We also provide a lot of work to drive awareness of what those new services are. Our team works with our regional head office in Singapore, and our regional head office in Singapore is responsible for serving advertisers across over 30 different countries in the region. So that is the first thing. The second thing we do in Australia is that we provide R&D services to Google globally. So we have about 500 engineers based in Australia, and they support the about 28,000 engineers Google has globally. In Sydney we work on products such as Google Maps.

So the way to think about us like an external agency. Google Australia gets revenue from two places. We get revenue from Google Inc. because of our R&D services, and we get revenue from Google Asia Pacific, based in Singapore, for our marketing and sales and service support that we give. Now, in order to calculate how much revenue and how much profit Google Australia should receive, we use something called the cost-plus basis, and we ensure that the revenue and the profit Google Australia gets is absolutely comparable to what an external agency or an external company would get if they provided the equivalent services. So, specifically for 2013, Google Australia was paid $358 million in revenue and we generated profits of just over $46 million, and as a result we paid $7.1 million in taxes. So that is the context.

So now let me answer the question, why is it that Google Australia does not pay more corporation taxes in Australia? And the answer to that is because, like many other multinational corporations, whether they are digital or otherwise, we pay the lion's share of our taxes to the country where our headquarters is based. That is because typically, head offices—and in our case, our head office in the US—are where we take the majority of our risk and where we make the majority of our funding in investments such as research and development. And that in turn is what drives our profits. So at Google, our success and our profits stem from our intellectual capital, and that is the technology that helps to drive things like the algorithm which provides what we think is the most relevant answer to whatever search you put into Google Search. It also drives things like the technology to help us do the auction that prices the advertising that you would see on YouTube or on Google Search. This intellectual capital was developed outside of Australia, and this intellectual capital is owned outside of Australia. It is very easy to underestimate the risks and also the costs that were required to today, to develop that intellectual capital. It is also very easy to underestimate the ongoing risks and investment required to develop the next type of innovation, such as driverless cars. For perspective, last year alone Google invested more than $9.8 billion in R&D. If you think back to when we made our first investment in Search, Google in the US funded that, even though there was already an incumbent well entrenched in the search space. When Google in the US made the decision six years ago to buy YouTube for $1.65 billion, that business at the time was generating virtually no revenue and was riddled with legal risk. In both cases, it was a very, very risky and a very, very expensive proposition for Google in the US to go after those business areas.

The explanation for why an Australian multinational, whether they be in mining or in biotech, is able to generate the majority of their revenue outside Australia but pay the majority of their taxes inside Australia is that the Australian based headquarters does most of the investing and carries most of the risk. The Australian headquarters invest in things like infrastructure and R&D, so it makes sense that the profits and the taxes made and paid are in Australia. That explanation is also why Google pays most of the taxes in our US headquarters, because the US is where the majority of our risks and our costs are borne.

I want to end quickly on tax reform. We believe that it is important not just for large companies but also small companies and particularly start-ups that we have reform in our taxes. We support reform to make our current system simpler and more transparent, but we do not believe that unilateral action by an individual country that basically puts at risk our tax treaties with other nations is the right solution. It will add more complexity and more uncertainty and will lead to less innovation and less growth and job creation. It is why Google believes international cooperation at the OECD level is essential.

However, we do also agree that there are areas where local action could be taken that does not undermine that OECD process. For example, there could be some thinking done on our existing R&D tax credits. My worry is that the system today is being used for business activity that would have occurred regardless of whether the tax credits were offered. Google currently both qualifies for and benefits from this R&D tax credit, and that is because our teams in Australia do very innovative work here. However, the R&D tax credits are not the primary reason we are investing in doing R&D in Australia. I do think those incentives, for example, could be better targeted to start-ups, and there are probably businesses all over Australia at the moment being started up in someone's garage that could be better served by getting them up faster and scaled globally faster, hopefully turning into the next Google or Apple or Microsoft, and those businesses could be headquartered in Australia.

Finally, thank you for inviting me here to participate today. I am proud of Google's contributions in Australia. There is always more that we could do. However, we are committed to Australia and we are committed to our users and our customers in this geography. Thank you, and I welcome your questions.

CHAIR: Thank you. Mr Sample?

Mr Sample: Thank you, Chair, and I thank the committee for the opportunity to provide evidence at this inquiry. I am the Corporate Vice President, Worldwide Tax, for Microsoft Corporation. I would like to make an opening statement about how Microsoft's business is structured. Our written submission provides more detail, but it might be helpful if I outlined the basic structure and where Australia fits in. Microsoft is incorporated and headquartered in the United States. Our mission is to enable people and businesses throughout the world to realise their full potential by creating technology that transforms the way people work, play and communicate.

I will take a moment to explain to you our business model in simple terms. Microsoft is a technology company. Eighty-five per cent of our R&D spend and headcount is based in the US, and the intellectual property is owned by Microsoft Corporation US. We deliver our hardware and software products and our services based on a regional operating model that has three distinct regions: the Americas, EMEA and APAC. We service our customers and our channel partners through local subsidiaries in over 100 jurisdictions. For FY14, our worldwide revenue was split evenly between the US and foreign locations. Our worldwide original equipment manufacturers, our OEM business, consisting primarily of the licensing of the Windows operating system to computer manufacturers for pre-installation on PCs, is primarily operated and supplied from our US regional operating centre, also known as a ROC. A resulting income is reported as taxable income in the US, fully subject to the US corporate income tax rate of 35 per cent. Our nine OEM or retail business is generally operated and supplied by our ROCs located in the following three regions: EMEA, APAC and the Americas. Each of these ROCs represents a significant investment in infrastructure and head count. The Singapore ROC group, organised in 1998, supplies products and services to the APAC region—also representing billions in customer revenue earned and operating expenses incurred, serving 18 countries throughout the Asia-Pacific, including Australia. The APAC group operating costs are funded by the Singapore ROC. The Singapore ROC groups employs nearly 2,000 workers and owns and operates data centre facilities that distribute software to APAC customers.

Regional production, marketing and G&A functions are performed by the Singapore ROC. The profits earned from the APAC business after appropriate taxable payments to the US group for technology rights and other support, and the payment of support fees to the local subsidiaries, are earned primarily by the Singapore ROC group. Microsoft local subsidiaries, such as Microsoft Australia, receive an arms-length compensation paid by the ROC, which takes into consideration the functions performed, assets owned and the risks assumed by each entity. Local entities are generally required to act under the direction of Microsoft Corp. with regard to the marketing campaigns, pricing terms and conditions, and policies and procedures. The local subsidiaries provide very limited input into the creation of marketing or technology embodied in the material provided by Microsoft. Our foreign ROCs pay tax locally in the jurisdiction in which they operate, and Microsoft pays US tax on the earnings of the foreign ROCs when those earnings are repatriated back to the US in the form of dividends or included in income under other provisions of the US Internal Revenue Code.

Microsoft also pays US tax on royalties and cost-sharing payments that are received from the foreign ROCs. Microsoft Australia Pty has operated in Australia for over 30 years and currently has around 960 employees. Microsoft Australia has over 10,000 channel partners, of which 69 per cent are Australian small businesses. These partners employ over 230,000 people in high-skilled jobs and they contributed over $19.5 billion to the Australian economy in 2013. I am happy to take your questions.

CHAIR: Thank you so much, and thank you for your submissions. I am going to ask only one question, and then Senator Ketter, Senator Milne, Senator Milne and Senator Xenophon, and we will keep going round. Ms Carnegie, if we get the chance I would love to ask you a bit more about the R&D proposal. I know it was in today's press. I think it is a very exciting idea and I want to say: it is very positive when people come to these kinds of inquiries to participate with new ideas as well.

Let us take a step back for a second and unpack something. Firstly, let's get some terms on the table that we can all agree on. There is a big difference between tax minimisation and tax evasion. Tax evasion is illegal. Tax evasion is a matter between businesses and the relevant authorities—in our case with the Australian Taxation Office—and we are not here to make accusations or allegations about tax evasion. That is a legal matter between companies and the tax office. You are all obviously very aware of the criticism that is levelled at tech companies, and your companies in particular. This is not a new issue for your companies to be dealing with. There has obviously been an incredible amount of community, public and media interest in this, and I just wanted to put the question to you to give you an opportunity to answer. I know other senators will go into more detail. The

proposition is effectively this: the Australian public do not accept that the structures that have been created by these companies are necessarily genuine, and there is a strong sense out there that companies such as yours, which do incredible work in terms of employment, which create fantastic jobs, which create innovative new products, also have a greater moral and social responsibility to give more back to this community and that the structures that have been created within your firms, be it through Ireland, through Singapore, through the US or through wherever, have been designed to minimise your tax obligation in this country. That is not a criticism of the incredible work that your companies do. It is a criticism of a corporate structure, as well as a sense amongst the Australian public and media that the structures have been artificially created and are not genuine. In saying that, I am not implying or saying that any of this is necessarily illegal behaviour. If it is tax evasion, it is a matter for the Tax Office, but the question is—and I am sure this has been put to you before—more about the morality of having these structures and whether your companies have a greater corporate and social responsibility that you are not meeting. I would like to put that one question to the three of you, starting with Mr King.

Mr King: Let me start by reiterating that we have a very simple business model. We book all of our revenues to do with our Australian sales here in our books in Apple Australia. We collect and pay GST on every single sale that we—

CHAIR: But the corporate tax is not the GST.

Mr King: Every single sale, including our online store sales—

Senator EDWARDS: iTunes?

Mr King: and iTunes. Apple in Australia and Apple globally is ostensibly a product company. So we make iPhones; we make iPads; we make Macs; and we have a smallish—in our revenue scheme of things—digital services business. We are ostensibly a hardware or product company, and so we book all of our sales in the books of Apple Australia—very clear, very transparent. We purchase our products on an arms-length basis from affiliates; we book all of those costs in the books of Apple Australia. We declare all of our income in accordance with Australian tax law and we pay all of our taxes that we owe. It is very simple—no offshore billing, no corporate debt, no fancy hybrid structures—a very simple business model.

Ms Carnegie: Google also has a very simple structure. We also use an arms-length pricing model to determine what the revenue and profit for Google Australia should be, but I think the question you are getting at is slightly more complex than that. As you said, it is the morality of the whole thing. I guess my answer to that is: fundamentally, Google does not structure itself based on tax; it structures itself based on being competitive. We are not opposed to paying tax; what we are opposed to is being uncompetitive. Just as Australia needs to compete with Singapore or Ireland or the US or the UK for various things, we need to compete with the people sitting at this table, as well as Tiensin in China and Alibaba, which is now incorporated in the US. We structure ourselves to be competitive.

When I think about morality, I do not think about it in terms of geographic boundaries. I also think it is a very qualitative statement. If I asked each one of you what is the appropriate and morally right tax to be paying, I would probably get as many different answers as the number of people sitting at the table. When you look at it internationally, the answer to that ranges from the UK, which says it is 20 per cent, through to Ireland, which says it is 12½ per cent, through to South Korea, which says it is 24 per cent, through to Singapore, which says it is 17 per cent—

CHAIR: And Bermuda says it is zero.

Ms Carnegie: through to Bermuda, which says it is zero. I do not know what the right answer is. As I said, Google globally pays a tax rate of 19.3 per cent. That was last year, but if you look at our five-year average it is closer to 20 per cent. If you look back at 2002, we were paying about 48 per cent tax. As I said, we are not opposed to paying tax; we are opposed to being uncompetitive. We have competition sitting at this table and all around the world. When I think about the morality of it, I think the people who need to give the right number are, quite frankly, the people sitting on your side of the room. What we need to do is to make sure that we are living up to that.

Mr Sample: Our Australian business is a direct result of business decisions made by Microsoft senior management decades ago. The company has been centralising its R&D functions in the US and we perform over 85 five per cent of our R&D in the US. In the early 1990s the company management decided to regionalise the production and distribution functions to reduce costs and improve efficiency in those operations. Microsoft develops products, produces software, distributes software and markets software. The R&D and development work is done in the US and the production, distribution and selling operations are done in the regional centres. As a result, in our market jurisdictions the Microsoft entities are marketing, service and support subsidiaries. That is

the nature of our business in Australia, and I believe that the profit attributed to our Australian business and tax paid is in full compliance with the Australian tax law.

Senator KETTER: Mr King, it has been reported that Apple paid $80 million on income tax on revenue of more than $6 billion.

Senator EDWARDS: Revenue or turnover? Are you talking about turnover or profit?

Senator KETTER: It is revenue. Mr King, would you describe Apple's tax planning approach in Australia as being aggressive?

Mr King: No, I would not. As I said before, our books and records are very simple. All of our sales and revenue are recorded in our books here, all of our cost of doing business is recorded in our books and our net income is clearly reported as well. Our tax is paid on our net income, and last year it was paid at an effective tax rate of just over 30 per cent.

Senator KETTER: Have I got those figures wrong?

Mr King: Our revenue in our most recently reported financial statements was approximately $6 billion—that is correct—and our income tax expense was around $80 million.

Senator KETTER: Can you explain how you get that effective rate of tax on a turnover of $6 billion?

Mr King: Yes. It is because the tax is paid based on the net profit; it is not based on the revenue. Every time we sell a product, there is a cost of doing business. A product like an iPhone is a very complex piece of technology that takes many, many years to develop and has enormous R&D expenditure associated with it. The cost of sale is in the books of Apple Australia; it is the cost of buying the product that we bring in and then distribute to our customers and to our partners in Australia. We pay our income tax on revenue minus all of our costs, which leads to an operating margin. The tax is calculated on the operating margin.

Senator CANAVAN: What is your operating margin in those accounts? Do you have that figure?

Mr King: The operating margin in the most recently published accounts was, I believe, approximately $250 million.

Senator CANAVAN: Out of $8 billion?

Mr King: Out of $6 billion.

Senator CANAVAN: Sorry, $6 billion.

Senator KETTER: What would you say is your effective tax rate in Australia?

Mr King: Our effective tax rate is 30 per cent. The worldwide tax rate for Apple globally is a little over 26 per cent. I believe it is between 26 and 27 per cent.

Senator EDWARDS: Let me try and help—because this is getting painful. Are you inflating the transfer price of all your goods to a point where you are lowering your gross profit to a point where you are minimising your income tax paid here? Is your transfer pricing being artificially inflated—

CHAIR: That is an allegation.

Senator EDWARDS: to gather profits in another jurisdiction?

Mr King: Not at all.

Senator EDWARDS: Okay, unpack that.

Mr King: Our product cost is determined on an arms-length basis. What is important to refer to in this discussion is the advance pricing agreement that we have had with the ATO for many, many years. Our APA experience with the tax office goes back to the early nineties. The APA process is a very rigorous and thorough process that is a framework to ensure the product cost in the transfer pricing concepts is fairly stated on products being brought into Australia by a multinational. That is a very, very rigorous process and it is reviewed annually. We have worked with the ATO since 1991 in establishing the costs of our products that we bring into Australia.

Senator KETTER: Are you saying you do not have strategies to reduce your tax in Australia?

Mr King: We pay our tax in accordance with the Australian tax law.

Senator KETTER: My question was: do you have strategies to reduce the amount of tax that you pay?

Mr King: No, we don't.

Senator KETTER: Do you know what your ATO risk rating is?

Mr King: I believe we are a low risk rating but high consequence because of our revenue size.

Senator KETTER: Do you have any subsidiaries in tax havens or secrecy jurisdictions?

Mr King: Apple Australia has one subsidiary, which is Apple in New Zealand.

Senator KETTER: Which subsidiary do you have in New Zealand?

Mr King: Apple Sales New Zealand, which is our sales operation for the New Zealand market.

Senator MILNE: I want to follow up on that question about Apple subsidiaries. We had evidence today from Professor Antony Ting. In his submission to the inquiry he said:

Another implication of the separate entity doctrine is that tax administrations are bound by the tax law and therefore in general have to respect intra-group transactions even if they do not have economic substance. Taking Apple's international tax avoidance structure as an example, it has successfully shifted US$44 billion to its Irish subsidiary from 2009 to 2012. The Irish subsidiary was a shell company with no employees before 2012.

Do you accept that that is a true statement?

Mr King: What I can say is that we book all of our revenue and sales that we do in Australia in our books locally, we book all of the costs associated with doing business here, we buy our products from affiliate companies within the Apple group and we pay all of our taxes on our sales here in Australia.

Senator MILNE: No doubt—that is what you are saying. I asked you about the allegation that Professor Ting made in his submission ,which is that basically you have an international tax avoidance structure—'a double Irish sandwich with Dutch associations'. What is a double Irish sandwich with Dutch affiliations?

Mr King: I have no idea what you are talking about.

Senator MILNE: Oh come on, you have not come here today to say that!

Mr King: What I can say is that all of our revenue is recorded in our books here, all of our costs of doing business are reported in our books and we buy products from affiliate companies outside of Australia.

Senator MILNE: So why does this money go straight to Ireland and then through the Netherlands and then back to Ireland? What is going on with that?

Mr King: All of our business here is clearly reported in our books.

Senator MILNE: I am not asking what you are reporting. I am asking you about this arrangement that you have.

Mr King: The arrangement that we have is very clear in the business that we do in Australia. All the revenue and all of the costs of doing business are clearly reported in our books here in the Australian market.

Senator MILNE: Professor Ting goes on to say:

… when Apple's Australian subsidiary sells an iPad for $600 to a customer in this country, it is estimated that about $550 (that is, approximately 90%) is shifted to Ireland. To make it worse, out of this $550, about $220 (that is, approximately 36%) is never taxed anywhere in the world. This is called "double non-taxation" in the tax world.

Are you involved in double non-taxation?

Mr King: I am not an international tax expert. I am not familiar with any of our tax activities offshore. I can talk clearly about our tax activities in Australia. When we buy an iPad, an iPad has a cost. Apple Australia pays the cost of that iPad when we purchase it from an affiliate within the Apple group.

Senator EDWARDS: That is the issue.

Senator MILNE: That is the point. What are you buying it for and what are you selling it for?

Mr King: We buy it for an arms-length price, which is determined in accordance with our advance pricing agreement, which has been clearly worked for many, many years on a consistent basis, transparent and open with the Australian tax office.

Senator MILNE: What I am asking you is: what are you buying it for and what are you selling it for?

Mr King: We buy it at an arms-length price.

Senator MILNE: Yes, I heard you say it is an arms-length transaction and your advance pricing agreement. What I am asking you, though, is: what is the actual dollar terms? What are you buying an iPad for and what are you selling it for in Australia?

Mr King: We are buying it at an arms-length price, which would be the same price—

Senator MILNE: I heard you say that. I said: how much?

Mr King: I do not have a specific dollar value for each one of our products here today.

Senator MILNE: Relative to what you buy and sell an iPad for in Australia, how does that compare with the price that you sell it for and the cost you buy it for in other places?

Senator EDWARDS: Say, America.

Mr King: I am not familiar with the tax practices in America. I can talk about the tax practices here in Australia. That iPad would be bought at the arms-length price, which would be as if Apple in Australia were an independent entity buying that product from an offshore—

Senator MILNE: Therein is the problem. You are acting as if you are a separate entity and you are not a separate entity; you are part of a global structure and you are fixing the prices around the world so you maximise your expenses here in this jurisdiction and then maximise your tax avoidance in a low-tax jurisdiction. Isn't that what Apple is doing?

Mr King: Senator, I reject that. We are following—

Senator MILNE: Why? What is wrong with that statement?

Mr King: We are following globally accepted transfer pricing principles. We are following Australian transfer pricing principles in everything that we do here in the Australian market.

Senator MILNE: I am not saying you are not following the law or you are not following principles. I am asking you as a matter of fact. You are sitting here saying that you are just familiar with the Australian tax arrangements of your Apple subsidiary here. What I am saying is that it is ridiculous to regard you as a single entity when you are part of a global company which is avoiding tax.

Mr King: We do not avoid tax. We pay all of our taxes that are due in the Australian market in accordance with the law.

Senator EDWARDS: You know where Senator Milne is going. It is getting painful again.

Senator MILNE: Yes.

Senator EDWARDS: If you buy an iPad for $550 in Australia and sell it for $600, you have tax on $50—that is your gross margin, right? Then you have costs out of that and that leaves your net profit. Your net profit might be $10, of which you pay 30 per cent, which is $3, on every iPad. However, in America or other more favourable tax jurisdictions, do you charge the equivalent of $550 or does your parent company charge $550 for the same iPad, or do they charge $220, which means your gross profit is much higher? Your costs may be similar, depending on the region you are in and therefore you have a much higher net profit. Am I helping you?

Senator XENOPHON: Very good questions.

Senator EDWARDS: I am going to go mad otherwise.

Mr King: I can only restate what we do here on the Australian market.

Senator XENOPHON: You are not answering the question.

CHAIR: You do not know?

Mr King: Senator, I do not know what we do elsewhere in the world.

Senator CANAVAN: How do you work out the transfer price? How do you calculate the arms-length basis for the iPad that you buy here?

Mr King: That is subject to the advance pricing arrangement with the ATO. And the transfer pricing—

Senator CANAVAN: But you do not have that agreement with them right now.

Mr King: For the worked example that we are talking about?

Senator CANAVAN: Yes.

Mr King: I do not have a specific number for every product that we sell.

Senator CANAVAN: But you said in your submission that you do not have an APA with the ATO any more.

Mr King: Our APA first started in 1991. Our most recent APA expired just recently—

Senator CANAVAN: Yes. So you do not have one right now.

Mr King: and we are just working on the basis—as if that APA were still in existence.

Senator CANAVAN: Mr King, we are mere senators—and you are not an international tax expert, I understand that. But you are responsible for a company that pays tax and is obviously involved in these arrangements to determine your tax. I think we are hoping for you to give us a layman's explanation of how you determine an arms-length price under these arrangements. It seems to me very difficult. It is not a simple business—you said your business is simple; this is not simple, because there is no alternative purchaser of iPads, there is no alternative market that we can go to to check this price and benchmark it. How do you determine the price, given it is an internal party or a related party transaction?

Mr King: So it is a function of a couple of things: first and foremost, the economic activity that Apple Australia undertakes here, and so we are a distribution business in the Australian market. We bring Apple product into Australia and it is sold. Second, when we look at specific products, we are looking at the arms-length test, and the arms-length test involves economists working through companies that would be similar in size, shape, and style to that of being a distribution company. And those comparables are pulled together, in conjunction with analysis that the ATO does on their side of the fence, to determine what an arms-length basis would be for imported products coming into Australia.

Senator CANAVAN: So is it a building-blocks approach then?

Mr King: It is a building-blocks approach from the bottoms up. It starts with, what does Apple do here? We do not do any development. We do not do any manufacturing. We distribute and sell products.

Senator KETTER: I just have a follow-up question on the issue of transport pricing. Have you had any adverse assessments in relation to your transfer pricing?

Mr King: No, Senator, we have not had any—we have never had any adverse assessments to the best of my knowledge, and I have been at the company for 12 years. And I do not believe we have had anything beyond that.

Senator MILNE: Are you under investigation currently by the Tax Office?

Mr King: Senator, I believe that approximately a dozen of the tech companies are being audited by the ATO—of which we are one—

Senator MILNE: Thank you.

Mr King: and we have been cooperating fully with the ATO in their audit of Apple.

CHAIR: Just before we move on, can I ask: is that the case for your companies as well, Mr Sample and Ms Carnegie? Are you all being audited by the ATO at the moment?

Mr Sample: Yes, Senator.

Ms Carnegie: I thought there were disclosure laws to say whether we can or cannot establish—

CHAIR: Parliamentary privilege, Ms Carnegie.

Ms Carnegie: Yes, we are.

CHAIR: Okay. So all three of your companies are currently being audited by the ATO.

Senator EDWARDS: And then some, by the sounds of it.

Senator KETTER: Mr King, you touched on the fact that your advance pricing agreement has not been renewed by the ATO. Do you have an understanding as to why that has occurred? Is it possible that the ATO believes that you are too aggressive in your tax planning?

Mr King: Senator, I do not believe that is correct. I believe our agreement expired, and we were in renewal discussions, and then an audit commenced with the technology companies about six to 12 months ago, and so those discussions are ongoing. Our desire is to renew our APA with the ATO. And the APA is a very rigorous and professional program.

Senator MILNE: I just want to follow up to the questions that have been asked in relation to Apple's cost of goods sold in Australia. Is it true that the cost of goods sold in Australia is much higher than globally?

Mr King: I do not have that data point today for you, Senator, but advance pricing agreements are very commonly implemented around the world.

Senator MILNE: Perhaps you could take on notice please to provide a comparison—

Mr King: I will take the question on notice, Senator.

Senator MILNE: We would be very interested to know the answer to that question. I want to now move on to Google. Perhaps you could explain to me what the double Irish sandwich with Dutch associations is since it is the thing that Google is particularly accused of. Nobody is going to accept the explanation that you have a simple tax structure so let us understand how starting from here we end up in Bermuda.

Ms Carnegie: I am not going to say that Google has a simple tax structure globally. What I would say is that we have a simple tax structure in Australia and Google Australia. Unfortunately, similar to my colleague, I am not a global tax expert. I can explain to you what I do know about Google's tax, but I will have to take on notice if you want to get into detailed international tax discussion.

The intellectual property of Google globally is owned by Google Inc., which is a US based company. Google Inc. then basically shares the cost and the risk of taking that intellectual property to market with another entity called Google Ireland Holdings. That is a company that is based in Ireland. There are then two operating

companies underneath that structure. One of them is called Google Ireland Limited and the other one is called Google Asia Pacific. Google Australia, as I said, basically provides sales and marketing support services to Google Asia Pacific and also provides R&D services to Google Inc. That broadly speaking is how we go to market.

Coming back to your question, I acknowledge there is a lot more complexity to the Google global tax structure than that. None of that other structure impacts the tax that Google pays in Australia. I can take on notice and come back and explain what goes on more explicitly in Ireland and other places but, to be frank, I do not have those details today.

Senator MILNE: I find it extraordinary that you do not because the whole point of this inquiry is to look at whether companies like Microsoft, Apple and Google pay their fair share of tax in Australia. You have already established you get very generous R&D concessions in Australia. We have established that—so you maximise the expenses in a country that pays substantial rebates and then you minimise the tax that is paid through these structures. As I understand it, the money that gets to Ireland goes to the Netherlands so that avoids the European complexities and gets you into a low-tax jurisdiction in the Netherlands. The money is transferred straight from the Netherlands to an Irish company located in Bermuda, which has no tax. So at the end of the day we are seeing a strategy surely for Google in Australia to maximise the costs here and to transfer as much as possible overseas and end up paying no tax on it at all. Isn't that effectively what Google Australia is actually doing?

Ms Carnegie: No, it is not.

Senator MILNE: Why? Why do you say that is not what is happening?

Ms Carnegie: I say that is not happening because, as I said in the beginning, we get an external company to do an audit and say what another company would be paid, both in terms of revenue and profit, if that other company were doing the work we do in Australia—if they were providing advertising and sales support or were doing that R&D, that engineering, here—and that is basically what we are paid and we then pay tax on that. As I said in my opening, yes, we do benefit from the R&D tax credit. We get a $4.5 million benefit from that. If we did not benefit from that, we would be paying 25 per cent tax so I acknowledge yes, we do get benefit from the R&D tax credit because we qualify for that. But the revenue that comes from Australia is taxed in Singapore, so the revenue from Australia is taxed. It is taxed in Singapore.

Senator MILNE: It is taxed in Singapore. Thank you. Now we are getting somewhere. So what is the relationship between Google Australia, Google Singapore and Google Ireland?

Ms Carnegie: As I said in the beginning, Google Australia provides sales and marketing services to Google Singapore, and we get basically revenue for those services. The other revenue from the market—the money that Google generates from, for example, business in Australia is paid directly into Singapore and that money is then taxed in Singapore.

Senator MILNE: And the costs associated with what Singapore charges you for the cost of those services, which gets the money transferred to Singapore, which is a low-tax jurisdiction. Is that correct? And who determines those costs?

Ms Carnegie: The costs for the services we provide are determined by going to an external party who, on an annual basis, looks at what an agency or an external company would charge for similar services.

Senator MILNE: Who is the external agent?

Ms Carnegie: I actually do not know the answer to that. I can come back to you on notice on that. But that is how Google Australia revenue and profit are determined.

Senator MILNE: Yes. So the tax is paid in Singapore, not in Australia.

Ms Carnegie: The tax for Google Australia, which, as I said, is a combination of sales and marketing services and R&D services, is paid in Australia. The tax generated from, for example, our advertising revenue, is paid in Singapore.

Senator MILNE: So the tax from your advertising revenue is paid in Singapore. Exactly. So we will get to Microsoft, and Microsoft is also accused of the double Irish Dutch sandwich. Is that the case?

Mr Sample: Senator, we do not and have never used a Dutch sandwich. Although I have heard the term I am not familiar with it. We do have a—

CHAIR: What about the double Irish?

Mr Sample: We do have a double Irish structure that was set up years ago and is in decline and represents less than 10 per cent of our Irish regional operating centre earnings.

Senator MILNE: Is that because the Irish government is now cracking down on it?

Mr Sample: No, that is because that business line that flowed through the double Irish structure has been declining steadily for a number of years.

Senator MILNE: When you sell corporate services in Australia, where are the sales people primarily located?

Mr Sample: The products and services we sell to Australian customers are sold by our Singapore group.

Senator MILNE: Thank you. So the sales people are primarily located in Singapore?

Mr Sample: That is correct.

Senator MILNE: And where does Microsoft bill its customers? From which jurisdiction?

Mr Sample: Our customers are billed by the Singapore group.

Senator MILNE: And are the services provided from Singapore?

Mr Sample: Microsoft products and Microsoft services provided to third parties related to online and other internet or cloud services would be provided from the data centres in Singapore.

Senator MILNE: Is the revenue for these services that are provided in Australia accounted for in Microsoft Australia's financial reports or results as reported to the tax office?

Mr Sample: Consulting services revenue is billed and accounted for on our Australian books and reported to the Australian tax office. Non-consulting services and software product revenue is billed and accounted for on our Singapore group books.

Senator MILNE: Thank you. So let's distinguish between those two. Can you give me a dollar figure in splitting the things that are accounted for in the Australian tax regime, or even a percentage, of what is then dealt with in Singapore?

Mr Sample: For fiscal year 2014, we estimate our Australian product and our customer product in service revenue of a price of nearly $2 billion.

Senator MILNE: I want the split, though.

Mr Sample: We probably book over $100 million of consulting services revenue on our local subsidiary books.

Senator MILNE: Just say those figures again.

Mr Sample: $2 billion in software products and services revenue booked in Singapore and a little over $100 million of consulting services revenue booked in Australia.

Senator MILNE: So $2 billion booked in Singapore and $100 million in Australia—and it just so happens that Singapore is a low-tax jurisdiction by comparison.

Mr Sample: It does not just so happen.

Senator MILNE: It is a happy coincidence, is it not?

Mr Sample: As I said earlier in my testimony, our management in the early 1990s decided to regionalise our product, production, distribution and sales activities. For the Asia-Pacific region, we decided that the location of our regional operating centre would be in Singapore.

Senator MILNE: I will go to a particular consumer service—for example, the Xbox platform. Where do you bill your customers from for that?

Mr Sample: The Xbox product will be billed out of Singapore.

Senator MILNE: Are the services provided from Singapore?

Mr Sample: That would be correct. I believe that is correct.

Senator MILNE: Again, is the revenue for these services accounted for in the financial results here or just in Singapore?

Mr Sample: They are accounted for in Singapore.

Senator MILNE: Just give me the relationship between Microsoft Australia, Microsoft Ireland and Microsoft Singapore. What is the relationship between those three entities?

Mr Sample: Microsoft Australia is not related in our legal structure to either Microsoft Singapore or Microsoft Ireland. Microsoft Singapore and Microsoft Ireland are not related, and there are no transactions between the two.

Senator MILNE: How extraordinary!

CHAIR: Who do you work for? Who pays you?

Senator MILNE: Who are you working for?

Mr Sample: I work for Microsoft Corporation in Redmond, Washington.

Senator MILNE: So why are you here, if you have nothing to do with this lot in this country?

Mr Sample: We decided, based on the nature of this inquiry, that we would try to answer your questions as best as possible, and I am the person in the company most familiar with the company's tax structure.

Senator MILNE: I am not suggesting that you are not welcome to be here, but I find it extraordinary that you are saying that these separate entities have nothing to do with each other—and here we are.

Senator EDWARDS: It is wholly owned by the mothership, is it?

Senator MILNE: Wholly-owned subsidiaries in each case.

Senator EDWARDS: Who are the shareholders of Microsoft Australia?

Mr Sample: Microsoft Australia is owned by a European holding company which is owned by Microsoft Corporation in the US.

Senator MILNE: So we are talking about the wholly-owned subsidiaries.

CHAIR: Did you fly over to Australia just for this inquiry today?

Mr Sample: Yes, I did.

Senator XENOPHON: Mr King, you have been with Apple for 12 years now?

Mr King: Yes, sir.

Senator XENOPHON: When was the last time you went to Ireland on business?

Mr King: I have never been to Ireland on business.

Senator XENOPHON: I find that strange, because, according to investigative journalists in this country, Apple in Australia has moved almost $9 billion in untaxed profits to its operations in Ireland. You have moved close to $10 billion to Ireland and you have never been there.

Mr King: Apple in Australia is owned by Apple Ireland. That is our parent company. I will reiterate that I have never been to Ireland for business purposes—only pleasure.

CHAIR: Do you FaceTime?

Senator CANAVAN: Do you FaceTime with Ireland?

Mr King: Not recently.

Senator XENOPHON: So you have shifted close to $10 billion in untaxed profits to a place you have never done any business with?

Mr King: We have not shifted any profits. We book all of our revenues here, all of our costs—

Senator XENOPHON: But you have shifted $9 billion from Australia to Ireland. Is that not the case?

Mr King: We have not shifted any profits outside of Australia.

Senator XENOPHON: No. I am asking: have you shifted $9 billion in revenues to Ireland, as reported?

Mr King: No, sir.

Senator XENOPHON: So what have you shifted?

Mr King: We have not shifted any profits.

Senator XENOPHON: Are you sure about that?

Mr King: Yes, sir, I am.

Senator XENOPHON: What do you say to this? Back in 2013, Apple reported pretax earnings in Australia of only $88.5 million, after sending an estimated $2 billion from its Australian sales to Ireland via Singapore, where Apple negotiated a secret tax deal in 2009.

Mr King: We are very transparent in everything that we do in the Australian market. All of our revenue, all of our costs, are clearly reported in our Australian business. We do buy products from affiliate companies outside of Australia, and we pay for those products.

Senator XENOPHON: Can I just go to a report of the United States Senate Committee on Homeland Security and Governmental Affairs Permanent Subcommittee on Investigations. It reported on 20 May 2013. The

US Senate concluded that Apple's tax arrangements have nothing to do with its business. Effectively it was highly effectively of Apple's tax arrangements. Do you know anything about that US Senate committee's findings?

Mr King: I watched the Senate inquiry at which our executive team presented, and they gave a very comprehensive description of Apple's tax affairs, not only in the United States but internationally, at that Senate investigation, and that is in the public domain.

Senator XENOPHON: As a consequence of that, the US Senate made quite significant findings against Apple about its activities—that it was aggressively minimising tax.

Mr King: I do not believe that there were any adverse findings against Apple from that inquiry.

Senator XENOPHON: We might dig that up. Ms Carnegie, when was the last time you went to Bermuda?

Ms Carnegie: I have never been to Bermuda.

Senator XENOPHON: Most of the profits of Google go to the tax haven of Bermuda. Are you aware of that?

Ms Carnegie: No, I am not. As I said in my opening, I believe that most of the profits are taxed in the US.

Senator XENOPHON: So, when Bloomberg Business reports that most of the profits went to the tax haven of Bermuda, which had a population, back in 2013, of 65,024 people, you are not aware of any of that?

Ms Carnegie: I am aware that Google has a relationship in Bermuda.

Senator XENOPHON: What is the tax rate in Bermuda? Remind me.

Ms Carnegie: I am not aware.

CHAIR: Zero.

Senator XENOPHON: If I said it was zero, would that be right?

Ms Carnegie: I would not debate it. I would take it on face value.

Senator XENOPHON: You are a senior executive for Google—their most senior executive in this country—and you are not aware that profits from Australia's operations somehow end up in Bermuda, where there is a zero tax rate?

CHAIR: It is a zero tax rate. It is actually zero.

Ms Carnegie: As I said, the profits from Google Australia—basically we pay them in Australia. The profits from the other revenue generated here are paid in Singapore. So those profits are taxed. They are taxed in Singapore.

Senator XENOPHON: What were your revenues last year in Australia? Can you tell us that?

Ms Carnegie: I am sorry; we do not disclose those.

Senator XENOPHON: And you do not disclose those either, do you, Mr King?

Mr King: We do disclose those. We reported revenues last year in Australia of $6 billion.

Senator XENOPHON: How much of that went overseas?

Mr King: We reported all of our revenue and all of our costs, and we—

Senator XENOPHON: No. I asked you how much of that went overseas.

Mr King: Our net profit was $250 million.

Senator XENOPHON: How much of the money went overseas? How much of that $6 billion paid by Australian consumers went overseas? Can you please tell us that?

Mr King: I will take that question on notice to give you a specific number.

Senator XENOPHON: Are you serious? You have come to this inquiry on tax minimisation and aggressive tax minimisation and you were not expecting a question like that?

Mr King: We pay using the 'arms-length' basis, which I have been into several times before. It is an established tax principle for the cost basis of all of the products that we bring into the country. All of this is clearly worked and disclosed with the ATO. It is very transparent in advance pricing agreement discussions with the ATO.

Senator XENOPHON: Mr King, I find it extraordinary that you cannot tell us that. I think it is important that this committee—and, Chair, as a voting member of this committee I will be asking that Mr King, and indeed all the witnesses, appear again. Maybe we can do it via FaceTime for you, Mr Sample.

CHAIR: That is not their product. It would be Skype.

Senator XENOPHON: Skype, sorry. So you cannot tell us how much of that $6 billion has gone overseas?

Mr King: We pay for all of our products—

Senator XENOPHON: No. Answer the question, please, Mr King. How much of the $6 billion that Australian consumers have paid for Apple products has actually gone overseas? It is a very simple question.

Mr King: We buy all of our products from international subsidiaries at an arms-length price—

Senator XENOPHON: You are not going to answer the question, are you?

Mr King: The purchase price of our products does go offshore. I will take that on notice to give you—

Senator XENOPHON: You were not expecting a question like that today, were you?

Mr King: I will take that on notice for the purchase price of our products last year.

CHAIR: To clarify for the purpose of the committee, do you not know or are you not telling us?

Mr King: I do not have the number.

CHAIR: You do not know the number?

Mr King: Correct.

Senator XENOPHON: Ms Carnegie, you cannot tell us how much money goes from Australia's operations to Bermuda, for instance, via a circuitous route?

Ms Carnegie: No. Again, because of US disclosure laws, I cannot declare what our revenue is—the revenue that goes directly from Australia to Singapore and that is taxed there. I cannot disclose that, but I can say that it does all go through Singapore and it is taxed in Singapore. It is a similar model, for example, to what an Australian multinational—pick someone like a Rio Tinto—does to its global revenue. For example—

Senator XENOPHON: Sorry to interrupt. The chair made the point that you are covered by parliamentary privilege. There is nothing to stop you from answering this question.

Ms Carnegie: Senator, I think this is going back to some of the issues we have that we need the OECD to help us to address. As I understand it, I am actually in—

Senator XENOPHON: You need them to help you, or you just need to pay—

Ms Carnegie: No. As I understand it, I would be contravening US disclosure laws if I declared what the revenue is in Australia.

CHAIR: I do not think that is correct but, anyway, it does not matter.

Ms Carnegie: I will take it on notice. But again, to be clear, if you look at someone like a Rio Tinto—

Senator XENOPHON: We will be looking at Rio Tinto.

Senator MILNE: Don't you worry!

Ms Carnegie: They have about 35 per cent of their customer base in China and they are paying less than one per cent of their tax in China because their headquarters in Australia bear the financial risks and the costs associated with that. Google has got a similar structure.

Senator XENOPHON: Mr Sample, have you ever been to the Cayman Islands?

Mr Sample: No, I have not.

Senator XENOPHON: You have not? Again, I am surprised, because Microsoft uses places such as the Cayman Islands, does it not? It funds a funnel from Microsoft to the Cayman Islands.

Mr Sample: Senator, to the best of my knowledge we have not used, and do not intend to use, the Cayman Islands.

Senator MILNE: Where do you use, then?

Senator XENOPHON: What about Bermuda?

Senator MILNE: Is it Bermuda, or where?

Mr Sample: We do have a licensing subsidiary in Bermuda.

Senator XENOPHON: Bermuda, I am sorry. They are close to each other. Are you the same William Sample referred to in a BBC article of a couple of years ago as Microsoft's vice president for tax?

Mr Sample: I believe so.

Senator XENOPHON: In Australia you are 'Bill'. We are more casual here.

Senator EDWARDS: You would have to thank Google for being able to find that.

Senator XENOPHON: I thank Google, and Apple for the device. Back in 2012 the US Senate Permanent Subcommittee on Investigations made findings on companies such as Microsoft and Hewlett-Packard. It criticised them for their use of tax avoidance schemes. The chairman of the panel said that their practices ranged from 'egregious to dubious validity.' Did you appear before that Senate inquiry?

Mr Sample: Yes, I did.

Senator XENOPHON: You are a sucker for punishment, aren't you?

CHAIR: How many inquiries have you appeared before, Mr Sample?

Senator EDWARDS: I suspect that they think Mr Sample is 'safe hands'.

Senator MILNE: The travelling witness!

Senator XENOPHON: You are not a novice in such things. You have appeared before Senate inquiries, a United States Senate inquiry where Microsoft was slammed for its behaviour. Yet Microsoft has not changed its practices since that 2012 Senate committee report with the findings made against Microsoft. Are still doing things as you were doing them three years ago?

Mr Sample: That is correct, Senator. Senator Levin did point out that everything we were doing was legal and in full compliance with the US tax—

Senator XENOPHON: It was just a 'dubious validity' and 'egregious'.

Mr Sample: That was the senator's opinion.

Senator XENOPHON: How much revenue do you take from Australia?

Mr Sample: Two billion dollars.

Senator XENOPHON: How much of that goes overseas?

Mr Sample: The revenue is in payment for products and services provided—

Senator XENOPHON: No, please answer the question. Please do not do this to me. How much of the $2 billion goes overseas?

Mr Sample: The $2 billion is billed by the Singapore group and it is paid to the Singapore group.

Senator XENOPHON: So all of it goes to Singapore?

Mr Sample: Of that $2 billion, that is correct, Senator.

Senator XENOPHON: Thank you for your direct answer.

Senator MILNE: I would like to follow up on this particular issue of how Microsoft has done this. In that US Senate inquiry I note that Microsoft sold the intellectual property rights to its subsidiaries in Ireland and in Singapore. Is that a matter of fact that the US parent company sold the intellectual property rights to those subsidiaries?

Mr Sample: All our intellectual property is owned by Microsoft Corporation in the United States.

Senator MILNE: I am sorry. It is not the IT; it is the licence to sell Microsoft in Europe and in Asia?

Mr Sample: Our Irish and Singapore regional operating centre groups have licensed the right to—

Senator MILNE: Thank you. They have bought the licence to sell those products in the regions.

Mr Sample: In exchange for significant licence payments back to the US made every year.

Senator MILNE: Those licences are paid back to the US and then those licence fees get passed on to the customers in Australia, et cetera, as part of the cost structure, which goes straight back to Singapore, which goes straight back to the US—or, more particularly, to Bermuda.

Mr Sample: The selling prices of our product and services to customers are in no way related to licence fees. They are not based on the licence fees that are paid by the regional operating centres to the US.

Senator MILNE: So why were the allegations made in the US that the licence fee arrangements have meant that they can essentially inflate the costs?

Mr Sample: I do not remember the PSI reaching that conclusion.

Senator MILNE: The headline article is: MICROSOFT: 3 YEARS - 6.5 BILLIONS IN AVOIDED TAXES. People can read that.

Senator CANAVAN: Mr King, Senator Xenophon asked you about the Homeland Security Senate committee in the US. Senator McCain put out a statement that:

Apple's corporate tax strategy reflects a flawed corporate tax system that allows multinational corporations to shift profits offshore to low-tax jurisdictions. For years Apple has opted to forgo fully contributing to the U.S. treasury and to American society by shifting profits and circumventing US taxes.

He concluded by saying:

The Subcommittee's investigation has uncovered a disturbing truth. Apple's three primary Irish entities hold 60 per cent of the company's profits, but claim to be tax residents nowhere in the world.

Furthermore, It is completely outrageous that Apple has not only dodged full payment of US taxes but has managed to evade paying taxes around the world 'through its convoluted, pernicious strategies'.

Senator XENOPHON: That is a Republican.

Senator CANAVAN: You are correct in that, Senator Xenophon. There is also a statement from Senator Levin, a Democrat senator, which I will not read but which made similar comments. They are pretty strong and bipartisan statements. How do you respond to those allegations?

Mr King: Senator, I watched the hearing at which our executive team presented to the US Senate. Our CEO and our CFO at the time and our head of worldwide taxation testified, and they provided a very comprehensive—I believe it was an hour and a half of testimony to the Senate—

Senator CANAVAN: Can you enlighten us at all?

Mr King: During those discussions, we were asked questions about what Apple's worldwide effective tax rate is, for example. And our worldwide effective tax rate is between 26 and 27 per cent. They were asked, what is the US effective tax rate for business done in America. And I believe the answer to that question was 30.5 per cent. Our executives at that testimony provided very, very detailed explanations on not only our US activities but also our international activities, and I believe that that testimony is available in the public domain for the committee to review.

Senator CANAVAN: Yes, I know; I have seen it. Those figures are based, obviously, on a calculation of taxable income; you know, tax paid on your taxable income gives you a proportionate figure. The question we have now is, how do you work that out? And what rules and strategies are you using to potentially minimise that amount—which it is your legal right to do, but which is obviously a public policy concern. I want to follow up on what Senator Milne was saying earlier, and take it really simple: I have been telling a guy called Joe Kelly, who is a journalist at *The Australian*, that I would buy his album on iTunes and I have not done it. So let's do it right here and now: I am online and I can see that that album will cost me $16.99 on your App Store. How much of that $16.99 do you report as income to the ATO? If I press that button right now—

CHAIR: This is the guy who forgot to bring his wallet, by the way—he is relying on all of us for cash at the moment!

Senator CANAVAN: Well, I have still got my iTunes account. How much of that $16.99 do you report to the ATO?

Mr King: That is all taken into consideration in the calculations that are in our advance pricing agreement. And so, whether it is the cost of a product coming to the country, that is, a piece of hardware; or content that is paid to a recording artist—and the tax that we pay in Australia is a function of the economic activity that Apple undertakes here in the Australian market, which—

Senator CANAVAN: So you report all of that $16.99. Is that in the $6 billion figure that you gave us earlier?

Mr King: The revenue is in there.

Senator CANAVAN: And I know you going to tell me you do not have the figure, but how much of that $16.99 is taxable income then, with the ATO?

Mr King: I would have to take that specific on notice.

Senator CANAVAN: If you could take it on notice, it would be very useful. It would help to clarify things for us. Because I obviously have made that transaction in Australia and, if I wanted—

CHAIR: You should have asked the question first, before you bought it!

Senator CANAVAN: Well, I am sure the music will still be good. If I move to you, Ms Carnegie, and if I instead now open Safari and google, say, phones, I am pretty sure it will bring up an ad for a Samsung phone—unfortunately, Mr King!—and I click on that. You will get some money from advertising revenue, presumably it is only in cents not in dollars, but how much of that do you report to the ATO? If I click on that ad, and you get AdSense money, how much of that do you report to the ATO?

Ms Carnegie: We do not report any of that. All of that revenue goes through to Singapore.

Senator CANAVAN: So even though I have clicked on that ad in Australia—and I have used Telstra's mobile phone network; it has all happened in Australia—none of that gets reported to the ATO.

Ms Carnegie: No. All of that revenue gets booked through Singapore, and gets taxed in Singapore.

Senator CANAVAN: What is the tax rationale for that arms-length transaction or that economic location? That transaction has happened here. I understand you have to pay costs for that, and for your IP, as you said earlier, that you would have to deduct from that income—but I have paid for it, I have clicked on the ad. It is for a shop in Australia—it is Harvey Norman, a Samsung Galaxy—I could go down there right now and buy it. Why is it that you do not report any of that income to the ATO?

Ms Carnegie: We have a bit of a different business model to other people in that we do not set any of the prices for that. That is all done via an auction. Price discussion is all basically done through technology, and the intellectual property and intellectual capital for that auction is very sophisticated. It takes hundreds, if not thousands, of engineers to create. It can all be run, quite frankly, outside of Australia. There is very little need to have people in Australia to be helping to look after that transaction.

Senator CANAVAN: Except for me, who is an Australian, who is effectively using your service and providing you revenue. The equivalent would be reading a newspaper or watching TV in Australia, and my eyeballs help provide them revenue, but we expect those media companies to pay taxes in this country. You are effectively a media company in one sense of the word, but none of that income is reported here. I find that extraordinary. From a public policy perspective, there is an issue there for us because it is economic activity that is occurring in Australia. It is leading to a store that is in Australia, but we cannot touch it.

Ms Carnegie: As I said earlier, if we look at how Australian multinationals are operating outside of Australia, for me it is not remarkably different—for example, an Australian mining company which is generating more than a third of its revenue in a market like China, yet is only paying China 0.4 per cent of its taxes. Again, these are international tax arrangements. What Google is doing in Australia is very similar to what Australian companies are doing outside of Australia. That is why, in my opening, I am not sitting here today trying to defend whether those practices by Australian miners or Australian biomedical companies or American companies or Google are right or wrong. It is simply the way the global tax system is currently working. We are trying to operate within that. If the government chooses to create a different system, then obviously we will abide by that.

Senator CANAVAN: I do not want to put you in too uncomfortable a position next to your alternative, Apple, there, but it seems to me that the iTunes store I just used is not that much different from the AdSense ad I just clicked on. Both of them have been created by companies away from Australia, yet Apple is reporting its income here and you are not. My question is: how much discretion do you have under the current law to make those judgements yourself, rather than the ATO saying you must report that here or that over there? Is it your choice as a company basically to say: 'That is our arrangement. We book it to an overseas entity'?

Ms Carnegie: It is a great question. To be frank, it is not one that I have asked, so I would like to take it on notice. I think it is a good question, and I will come back and give you an answer to that.

Senator CANAVAN: Mr Sample, I did not want to leave you out of this. I have already paid 12 bucks a month or something to access Microsoft Office. I have already done that. I cannot do it again. I think it was pretty clear from your answers to Senator Milne and Senator Xenophon earlier that that $12 a month goes offshore. That is part of the $2 billion.

Mr Sample: That is correct.

Senator CANAVAN: If I go into JB Hi-Fi and buy Microsoft Office, does all the money from that go to your Singapore entity as well?

Mr Sample: When you buy it from the hi-fi store, the money you paid the hi-fi store goes to an Australian business. The Australian business would have acquired that software from the Microsoft Singapore group.

Senator CANAVAN: So all that money goes to Singapore?

Mr Sample: Yes. Then there is a margin for the Australian business.

Senator CANAVAN: Yes. What they value-added here would be taxed. I just want to go back to what we were talking about before on the transfer pricing. I am mindful of time. I will try to keep this to five minutes or so. Mr King, you mentioned that you use a building blocks approach, but this question is for everybody. I am still interested to know how you come up with those costs and that building blocks approach?

For example, for an iPad for $600 or whatever it costs, how much of those costs are for physical wages you are paying people in China or for the aluminium or glass that you buy—things that we can pretty easily measure?

What proportion is for a physical constraint and what proportion is for intangibles—marketing, fixed costs, overheads or IP et cetera?

Mr King: I will break that down into two portions. The economic activity that we undertake in Australia is very, very clear: wages for our people, all the buildings, leases, activities that we undertake and then an assessment of all of the value that the Apple team in Australia contributes to the distribution of our products in the Australian market. So a lot of that is time and costs of staff. The first part of the building blocks in an APA process is to ascribe value to the economic activity that is undertaken by a multinational such as Apple in the Australian market, then that is essentially worked up the stack to the product side. Each one of our products is intensely complex and is a mix of components, hardware, software and many, many years of research and development. I do not have the numbers for the split between intangibles and tangibles off the top of my head.

Senator CANAVAN: Presumably you are using some method of cost accounting to tally up all the costs of a global business and allocate those to different products. A lot of your costs would be overheads, I presume—or common, or fixed, costs.

Mr King: A great deal of the costs within Apple is for the procurement of components. The manufacturing processes associated with the building of our products is an enormous cost load in terms of operations and transference of products around the world, and a very considerable amount of money goes into research and development and all of those intangibles. All of that development activity is undertaken in our headquarters in Cupertino in the United States. That is where all product design takes place.

Senator CANAVAN: In this allocation of your costs to Australia—that is, the transfer price to Australia—so for the Australian who is buying an iPad from somewhere overseas to sell here, do you charge every Apple subsidiary around the world the same price for that iPad? Is the iPad you are buying here in Australia the same price as what a Singaporean or—that is probably not the best example—an Indonesian Apple would buy it for? Is it the same price across the world, or do you allocate your costs differently?

Mr King: To the best of my knowledge it is consistent around the world.

Senator CANAVAN: Could you take that on notice, and consistency from then what I mentioned was the same.

Mr King: I took that question on notice before. The APA process that we have in Australia is deployed in many of the OECD tax jurisdictions around the world. The process of determining the transfer price is consistent here with principles that would be deployed in other tax jurisdictions around the world. But I will take the overall question on notice to give you more specifics.

Senator CANAVAN: Thank you very much for giving us the figure for, I believe, the last financial year—that is $6 billion, is that right? I get a taxable income margin of 4.1 per cent, which is $250 million on $6 billion. It seems low. I know you have got other costs and you do not necessarily have all that much value added here in this country, but it still seems a relatively low margin. Could we get those figures for, say, the last five years for your organisation?

Mr King: Yes. They are published accounts—we can provide that on notice.

Senator CANAVAN: Ms Carnegie and Mr Sample, is there any possibility of doing the same for your organisations and your entities—your taxable income and your gross revenue. Obviously then it is a simple calculation to get the taxable income margin.

Ms Carnegie: Yes, Senator.

Senator MILNE: Ms Carnegie, where is the intellectual property for Google Maps now held?

Ms Carnegie: It is located in the US.

Senator MILNE: Where was it developed?

Ms Carnegie: Google acquired a start-up—that had about four people—from Australia. We acquired that—I believe it was back in the early 2000s. And, when we acquired it, we acquired the intellectual property. When I say 'we', Google Inc. acquired it and acquired the intellectual property of it. Again, it was a team of about four people.

Senator MILNE: So the intellectual property was developed here, with an R&D tax credit to Google?

Ms Carnegie: I do not believe so, because it was a start-up that we acquired. I have no understanding of how that start-up operated before Google acquired it.

Senator MILNE: Could you take on notice, please, the development of the IP for Google Maps here in Australia, the tax breaks that you got for that and then the decision to take it to the US?

Ms Carnegie: Just to clarify: do you want to know the tax break that the start-up did? I am not sure I can get that.

Senator MILNE: I want you just to provide what information you can about Google acquiring the intellectual property for Google Maps and then taking it offshore.

Ms Carnegie: Yes.

CHAIR: Just very quickly Senator Ketter has one or two follow-on questions, and then I will wrap up.

Senator KETTER: Earlier—I might have got these figures written down incorrectly—Ms Carnegie, you mentioned that you paid $7.1 million in tax.

Ms Carnegie: That is correct.

Senator KETTER: Can you just go back over those figures again for me? You also mentioned a figure of $358 million in revenue and $46 million profit. This is from your Australian operation?

Ms Carnegie: Yes. That is from Google Australia.

Senator KETTER: So you have paid $7.1 million in tax in Australia.

Ms Carnegie: Yes, for 2013 in Australia.

Senator KETTER: What effective rate of tax does that represent?

Ms Carnegie: On $46 million, $7.1 million is 15 per cent. As I said before, we did claim $4.5 million of R&D credit, so, if we had not claimed the R&D credit, then the tax rate would have been closer to 25 per cent.

Senator KETTER: Does your company have an advanced pricing agreement with the ATO?

Ms Carnegie: We do not. We tried to enter into an agreement, but then I think they were shut down in a similar circumstance.

CHAIR: Because of the audits?

Ms Carnegie: I am not sure why, but we did reach out and wanted to start that conversation.

Senator KETTER: But you have been in Australia for some time.

Ms Carnegie: Yes. We have been in Australia since about 2002.

Senator KETTER: And, since that time, you have not been able to secure an advanced pricing agreement?

Ms Carnegie: We only tried relatively recently. Again, when you think about advanced pricing, our price for our products is through an auction, so, outside of the services we provide, there is no kind of intercompany pricing negotiation, because we do not actually negotiate prices; it is through the auction, and whatever is paid through the auction goes directly through to Google Asia-Pacific. So, again, the advanced pricing arrangement would simply be for the marketing and sales services we provide and the R&D services we provide, and we only really approached the Australian tax office relatively recently about potentially putting that into an advanced pricing agreement.

Senator KETTER: Do you know what your ATO risk rating is?

Ms Carnegie: I do not.

Senator KETTER: Are you able to find out?

Ms Carnegie: I can try. If they will tell me, I will.

CHAIR: On this question of the audits, can I just touch on something? All three of you are being audited at the moment. We had the ATO here earlier. They said there are 12 or so tech companies—I think that is their figure; it is not a matter for you because you only know about yourselves. How long is this auditing period going to go for? Have they given you an estimated end date? How long is this going to go for before we get to the next stage?

Mr King: They have not given us an estimated end date. I think that would be a question for the ATO.

CHAIR: And none of you at the moment have an advanced pricing agreement?

Mr King: We have had an advanced pricing agreement—

CHAIR: You have had. It expired?

Mr King: which expired.

CHAIR: None of you have one?

Ms Carnegie: No, we do not.

Mr Sample: No.

Mr King: We are continuing to work under the assumptions of our old advanced pricing agreement in the way that we calculate and remit tax.

CHAIR: I want to wrap up, because I am very conscious of time. In wrapping up, there are a few things I want to put on the record. Firstly, I cannot thank you enough for making yourselves publicly available, making yourselves available to come here. I want to stress that you came very willingly and happily, and that is very much appreciated—Mr Sample, in particular, travelling all the way from the US just to be here. When did you arrive?

Mr Sample: Sunday.

CHAIR: So you took a few days.

Mr Sample: It is a beautiful city.

CHAIR: When do you leave?

Mr Sample: Tomorrow.

CHAIR: I do appreciate you coming all this way. You can come to Canberra tomorrow for our inquiry there. I do want to thank you, Mr Sample. In wrapping up, I want to take a step back for a second and say that I think there are some very legitimate community concerns about how your companies are structured and how your companies have engaged in what appears to be—as reported in media story after media story—tax minimisation. I am not making the accusation that the behaviour has been illegal at all, but the structure, when we break down your companies—when it came out that none of you had ever visited places like Bermuda and Singapore and Ireland, yet that is where all of the recipients of Australian sales are going—does nothing but raise those concerns. I also have to say it is pretty alarming that some of you would come to an inquiry like this without basic information about where revenue is going, where the Australian sales are going and what proportion of the Australian sales are going. I know Senator Xenophon is very strongly of the view—and he has had to catch a flight—that there are some questions that still need to be answered. They will continue to be pursued. I want to apologise to Ms Carnegie. I was very keen to ask you some questions about the R&D stuff you put out today. I think it is really exciting. I think it is a very positive development. I think Google should be congratulated for coming to an inquiry like this with a positive, new, big idea. I think that is a step in the right direction.

Senator EDWARDS: And also to point out that Google has a massive research and development commitment here. I think you have about 500 technicians here which, sadly, is not the case with all your peers. You have a massive R&D footprint, so you are quite credible on this.

CHAIR: The respect we have for your companies—I am sitting here with an Apple phone and an Apple iPad, getting notes on Microsoft Word, all of this—for your products and for your contribution, unfortunately, in my case—I cannot speak for other senators—does not extend to the concerns we have about how these companies have been arranged, particularly at an international level, for tax minimisation.

So where do we go from here? We had the Australian tax office here this morning. We have now been made aware that the tax office is auditing all of you going forward. We will be talking to Treasury and its Revenue Group. We believe, or I certainly believe, that the role of this committee is to explore opportunities that allow us to make sure there is a fair share of tax being paid in the Australian jurisdiction and that it is done in an appropriate way. We will be making a series of recommendations at the end of this process as part of the report to government. The objective is hopefully to try and make that as bipartisan as possible, but obviously that will come down to the detail and what the recommendations are. I do not think this is the end of it. I think Senator Xenophon is keen to pursue some of these matters. I am conscious of time. I think we will leave it at that, and we will return with representatives of News Corporation.

Proceedings suspended from 15:23 to 15:31

CLARKE, Mr Julian, Chief Executive Officer, News Corp Australia

PANUCCIO, Ms Susan, Chief Financial Officer, News Corp Australia

CHAIR: We will now resume this Economics References Committee inquiry into corporate tax avoidance and aggressive minimisation. I welcome the witnesses from News Corp Australia. I want to acknowledge and put on the record that, as with all our witnesses today, the team at News Corp, and Mr Clarke in particular, were incredibly forthcoming and I understand were very willing to move around other business and travel arrangements to participate in this inquiry. On behalf of the inquiry, as we have said to our other witnesses today, we appreciate the effort that people go to to be able to participate in this process. Mr Clarke, there will be a few questions from different senators. Before we get to that, would you like to make an opening statement or some opening remarks?

Mr Clarke: Yes. Good afternoon, Senators, and thank you for the opportunity of being here. I do want to make some opening remarks. I will try to keep them as brief as I possibly can. When we received, in October last year, the request for a submission to this inquiry, I noted that there were a number of points that you wanted us to address, and we are going to do that. They were our company tax arrangements for News Corp Australia; the effective tax rates; the strategies for minimising tax that we may or may not have; and, of course, global tax evasion. That brought me to ask myself, if I had to answer a question from you people, 'What is our corporate philosophy, if you like, our principle on corporate tax?' I would define it as this: we want to pay, we must pay, the right amount of tax—no more and no less. That is our corporate position.

I have come to that point because we have, I think, two important obligations. The first is to the nation, and that is to pay the right amount of tax. So there is a national obligation there. The second, of course, is to our shareholders, because the shareholders want to know that we are complying with the law and that we are arranging our financial affairs in a fair and efficient way. So I sit here today confident that we are doing exactly that with the corporate laws that apply in Australia.

In our submission, which I hope you have copies of, we went into a fair bit of detail, because I want to be as helpful as I can, along with my colleague Susan. We have given you five years of financial data for News Corp Australia. We have included our accounting profit for each of those five years; the effective tax rates, as you asked; the actual tax paid, which you did not ask for but which we have included; and a number of notations, which I thought we needed to give you to help you through some of the figures. So we are happy and expect to take detailed questions on that little bit later.

If I had to encapsulate that into a summary, the numbers that I am hoping you will remember are these. In those five years, the last five current years, we had an accounting profit before tax of $815.9 million. We paid corporate tax of $292.5 million. In other words, as a percentage, it was 35.8 per cent of our accounting profit. In addition to that, we paid withholding tax of $124.8 million. So the total tax pay for us in those five years was $417.3 million. In addition to that—of course, it is not corporate tax—there is another $900 million over those five years of FBT, GST and payroll tax. So the total tax take from News Corp Australia in those five years has been $1.32 billion.

I know I do not need to explain this to you people, but the public at large, and I suspect some of the people that have been making comment about this in recent days, do not understand the complications. And there is a difference, of course, between the accounting treatment and the tax treatment. If I were to give you an example of that—it is a minor example, but this sort of difference between the accounting treatment and the tax treatment pops up in any conversation you have about accounts—a good example would be annual leave. In a company like ours, where we have 9,000 employees and a payroll bill of $1 billion a year, the accounting treatment of that is that we take up the whole provision. In other words, if I have four weeks leave due to me, as an accounting principle we take the whole four weeks up. But, from a tax point of view, if I have only taken one or two weeks annual leave, it has a completely different tax out-take. So we are forever wrestling with this difference between the accounting treatment and the tax treatment. One point that I do want to emphasise is that, for News Corp Australia, 98 per cent—in fact, I think it is higher than that—of our total revenue is written here in Australia. Of that revenue, all of the tax on the profit that we make out of that revenue is paid here in Australia through the Australian Taxation Office.

You asked us to describe, if you like, the corporate structure, which I am going to do. But there have been two significant events in recent years that I need to give you some detail on. The first happened in 2004, where the old company—that is, The News Corporation Limited, TNCL, as we used to call it—was re-domiciled from Australia to the United States. That happened in 2004. You would have to ask: why did we choose to do that? It was to gain better access to much larger capital pools, particularly other global markets. That was the reason for doing it. When you do something like that, it is a tremendously complex structural arrangement and there are a lot of legal

details that go with such a change like that, which included the movement of shares. I spell this out because it goes to some of the comments that have been made loosely in the media in recent days. And it also required us to create a new company here in Australia, News Australia Holdings, NAH, to house all of the old historical businesses, which are still operating, which started here in Australia 90 years ago. So that was the first of these significant events.

The second one was more recently, in 2013, when the News Corporation United States company, the parent company, split into two. It split into 21st Century Fox and also into News Corporation. Again, a reasonable question is: why would the company have done that?

If I can quote Mr Murdoch himself, it was to:

… unlock the true value of both companies and their distinct assets, enabling investors to benefit from the separate strategic opportunities resulting from more focused management of each division.

I am happy to report that so far, so good. For example, the share price for News Corp here, for Australian investors, has increased 17.8 per cent in that time, and for 21st Century Fox investors it has increased 15.2 per cent. So the reasons given have actually been demonstrated in output.

You would have been hiding under a rock if you had not been aware that we have as a company been subjected to what I consider to be an outright attack by Fairfax in recent days. Such quotes as the headline breathlessly said on Monday in the *Sydney Morning Herald*—

Senator EDWARDS: They are still at it, by the way. I am looking at it now.

Mr Clarke: No doubt they are. But the headline there was 'Murdoch's US empire siphons off $4.5 billion virtually tax-free'. It then it goes on to say that, as a result of that, $1 billion was lost to the Australian public purse. The explanation that they have given for this claim is somehow we avoided paying withholding tax on the dividends. I am assuming when we get to the questions and answers that you are going to be asking me for detail on that. But, just in case you do not, let me say that these comments are either intentionally misleading or they do not have a clue about what they are talking about. In the case of the author, I think it is a bit of both. We are of course demanding a correction and we will see whether that is forthcoming.

If I can just move on, please—I will be as quick as I can—to the corporate history here. As I said, we have been going as a company here since 1923. Everything that happened started here. It was designed and built in Australia many, many years ago. Currently we have 9,000 employees. There are another 30,000 people probably in some way dependent on it—working for or on behalf of News Corporation. We are the largest employer of journalists here in Australia. In any one month we have 15 million Australians using our products, either print or digital, in some way.

I suppose the corporate history of this company is that it is both an acquirer and a builder. I lived through the Herald and Weekly Times takeover back in 1987, when that was the largest takeover in the corporate history of Australia. It was $2 billion, so a huge acquisition then. Of course, in subsequent years we have been a builder of business. *The Australian* is probably the best example of that, now 50 years old. We are very proud of that. But Foxtel, Fox Sports and our newest addition, REA, are all companies that have been built from the ground up with huge investment, involving people, technology and, I would say, a very high fixed cost base as part of the company.

If I can just give you a personal view on corporate tax. I consider corporate tax to be a very important but nevertheless the last piece in the puzzle. Upstream from corporate tax are all the things that are either going to make Australia great or in fact going to make our company great, and they are things like creating new businesses, growing existing businesses, creating new markets, being involved in developing new technology and creating new employment. I would say to you that from a national point of view the great challenge for Australia, particularly when you start talking about corporate tax, is for us to actually grow the economy and create employment with it. Of course, in that purpose we share a common cause with our company here.

I have some last comments, if I may. We find the Australian tax system incredibly complex, and you have to ask why. I am a very average sort of person. It is beyond my comprehension, the amount of detail that a company like ours has to deal with. I am not suggesting that it is not all important—it is—but surely there is a way of simplifying it. Above all, if I could make a suggestion—and I am sure it has been made previously today—it is that we all need to be able to play honestly on a level playing field.

For example, Netflix have just come into this country. Netflix do not pay any GST. They have been able to price themselves below the company that we have, which is Presto, but it is not just us. It is the Fairfax joint venture with Nine, with their streaming company. So this is an unfair, unlevel playing field and we would certainly be looking for parliament to fix that problem. The other thing that—

CHAIR: Before you move on, if I could just ask a question about that specifically. Is the concern you are raising about the GST treatment of them compared to the GST treatment for you?

Mr Clarke: Yes. It just means it is unlevel. The playing field is not level when two of the companies, ours and the other joint venture, have to apply the GST to the selling price, whereas a company can walk in from overseas and not have that. The proof of that is that they have priced themselves below our two organisations—the two organisations to which I refer.

The other thing that I think is worth having a look at is other foreign media companies operating online in Australia and selling advertising in this marketplace but invoicing that advertising from overseas. I think that is something you should definitely have a look at, because clearly that is a way of routing income outside of Australian shores.

CHAIR: That is how Google ads operate as well, though. We just found out it goes to Singapore.

Mr Clarke: Yes. Those two factors I think are probably a way of describing the unlevel playing field that we feel somewhat passionate about. So I end up where I started. That is, as a company—and I take full responsibility—it is our responsibility to pay the right tax, no more, no less. We have an obligation not only to the country but to our shareholders to do so. Thank you for hearing me out.

CHAIR: I have a few detailed questions. But, before we get to that, I know that Senator Edwards has to leave right on four o'clock, so he is going to ask a question or two first. Also, I ask all senators to be very conscious that we have one other witness, from the Property Council, to get to today as well.

Senator EDWARDS: I will be very brief. I only have two questions. Mr Clarke, as a very large taxpayer in this country—and you can argue about how much you do pay, and we will talk about that—do you think it is outrageous that the tax commissioner does not disclose the affairs of taxpayers of this country publicly? There is a story running this afternoon that Joe Hockey has effectively silenced the tax commissioner—

CHAIR: It was a letter from the tax commissioner.

Senator EDWARDS: or has authorised the tax commissioner—

CHAIR: I will read the letter again if you want.

Senator EDWARDS: In fact, the tax commissioner said he sent a minute and the Treasurer acknowledged it. There is a story running today saying that—

CHAIR: That is not what the tax commissioner said. He wrote us a letter.

Senator EDWARDS: Hear me out. The Treasurer authorised the tax commissioner. Do you understand that a statutory officer—

CHAIR: Don't drag them into the political—

Senator EDWARDS: No, he is a big taxpayer.

CHAIR: Seriously!

Senator EDWARDS: I want to know whether Mr Clarke feels that the tax commissioner should release details of their company publicly, whenever, at his whim.

Mr Clarke: I am aware of the comment and the story that is running and I am somewhat careful in how I answer it. I think as a principle our company would agree that more disclosure, more transparency, is a better thing. The problem that I have is that, in putting this paper together for you, we went into as much detail as we possibly could. I have to tell you, the people inside our organisation, my colleagues here, have thrashed around for the last two or three days trying to find ways that we could simplify for you people what we have here. So I do not have a problem with disclosure at all. In fact, I think it is our corporate responsibility to be open and frank with the public at large and certainly with the powers that be, the parliament, to disclose these things. But let's be careful that in disclosing them we are actually adding information to the public at large, who can then consume it.

Senator EDWARDS: Sure. There are some vagaries, inconsistencies and 'horses for courses' in what is appropriate, but that is at the discretion of the tax commissioner, isn't it?

Mr Clarke: Yes.

CHAIR: It is a fact of law.

Senator EDWARDS: And that should always remain so. In fact, the then Assistant Treasurer, on 29 September 2010, now the Leader of the Opposition, Mr Shorten, said:

The inconsistencies and ambiguities associated with the existing law have the potential to undermine its primary purpose—that is, to provide clear protection for taxpayer information. The taxation law has long recognised that such protection is fundamental to ensuring that taxpayers maintain their confidence in the operation of the tax system.

That is a basic tenet, and it is obviously shared by Wayne Swan, as I said earlier today, and by the now Leader of the Opposition, Mr Shorten. I do not think he has changed his view. It is shared by the tax commissioner and I think it is shared by the Treasurer of this country. Given the consensus, in the interests of disclosure, as you have just said—and you have been effusive with the information you have provided this committee—do you think it is a low road to go down if we just open the floodgates to information? Do you think our tax system can cope with that given that it is an honesty system?

Mr Clarke: I am not sure that I am in a position to answer that question.

CHAIR: It is a nice try, but I think it is a bit unfair to be dragging our witnesses into that area.

Senator EDWARDS: I will move on to the next point. The New South Wales accounting academic Jeffrey Knapp has asserted that, over the past 10 years, Mr Murdoch's companies here have paid income tax equivalent to a rate of 4.8 per cent on $6.8 billion in operating cash flows, or just 10 per cent of operating profits. Is that true?

Mr Clarke: No, it is not, and it is absolute nonsense. But I think what I am here to discuss is the Australian business, and I am only in a position to give you detailed information about what is happening here in Australia, which is what we have enclosed in our submission. I read that stuff yesterday and it just does not make any sense. I have to say that I think the gentleman to whom you refer is probably an accountant specialist and probably not a tax specialist—I am not sure. We are happy to give a detailed response on this very question at any time, but they have clearly got it hopelessly wrong, as I have already said.

Senator MILNE: Thank you for coming along today. I noticed, Mr Clarke, that you said that you are so proud of *The Australian* that you support building existing businesses and creating new employment. I am interested that you would say that, given the loss that *The Australian* runs at. Can you tell me: what are the tax benefits that you get from running *The Australian* at a loss?

Mr Clarke: If it is a choice that I make between making a profit on a newspaper and paying tax or, on the other side, getting some tax benefit, the preference is always to make the profit. With due respect, I probably do not expect you to agree with this, but I consider *The Australian* newspaper to be the finest national newspaper operating here in Australia.

Senator MILNE: You are right: you and I will not agree on that.

Mr Clarke: But you are in a minority.

Senator MILNE: Not judging by the number of people who buy your newspaper.

Mr Clarke: How many papers do we sell today?

Senator MILNE: You sell a very small number of papers across the country.

Mr Clarke: How many?

Senator MILNE: The issue here is that you run *The Australian* at a loss and I am asking: why do you continue as a business when it is not profitable?

Mr Clarke: Because we think it is a very important part of our total business and I make no apologies for the fact. *The Australian* is actually a very important part of our total newspaper operation and, journalistically, I think it is very, very important inside Australia. You will not necessarily agree with the reasons that we give for this, but we think that Australia, this nation of ours, needs a very strong national newspaper like *The Australian* to do exactly what it is doing.

Senator MILNE: And what is it doing?

Mr Clarke: It is absolutely involved in policy—in understanding the parties that are operating and the policies that they bring to the fore.

Senator MILNE: That is absolutely correct.

Senator CANAVAN: Can I ask a follow-up question?

Senator MILNE: No.

Senator CANAVAN: We have been very generous all day, Senator Milne.

CHAIR: Senator Canavan, just one follow-up question and we will let Senator Milne finish her questions.

Senator CANAVAN: I just wanted to explore this issue—it is relevant that Senator Milne has brought it up—about what you provide. There are really only two national newspapers in the country, anyway, that I can count.

The *Financial Review* is a very good paper as well, in my view, but it is a niche and serves quite a different purpose. What is your competitor in this field? It is a national newspaper covering policy pretty much across the field. Is there anyone else doing this sort of thing?

Mr Clarke: No, there is not, but I can tell you that, if for some reason *The Australian* was not there, there would be nobody doing what we are doing.

Senator MILNE: Precisely.

Mr Clarke: We have a difference of opinion as to why we are doing it.

Senator MILNE: Yes, we have.

Mr Clarke: Every time you tell me that we are trying to do this to run tax losses, I will tell you that we are not.

Senator MILNE: I accept that you are doing it for an ideological purpose.

Mr Clarke: Okay, I am happy with that.

Senator MILNE: Good, thank you. Can we come back to the issue?

CHAIR: Senator Milne.

Senator MILNE: I would like to go to the stories that have come out recently with regard to Rupert Murdoch's empire siphoning $4.5 billion from Australian business virtually tax free—this is the story you were referring to. I would like to start off with the structure of News Australia Holdings. What are the shareholding entities of News Australia Holdings? It has been reported there are three; what are they?

Ms Panuccio: When you say it has been reported that there are three, sorry, I do not understand. There are lots of companies that sit within News Australia Holdings.

Senator MILNE: Yes, subsidiaries of News Australia Holdings, but who are the shareholders in News Australia Holdings as such?

Ms Panuccio: Ultimately, the parent company in New York, News Corporation.

Senator MILNE: Only the parent company in New York? There are no other subsidiaries—no other shareholders in News Australia Holdings?

Ms Panuccio: Based on my understanding and what I have seen, it flows directly through to the New York company, and we are 100 per cent owned by the New York company. There may be entities that interface between them, but they are between Australia and America. There are no other companies that exist between them outside of that.

Senator MILNE: So News Australia Holdings has only one shareholder and that is News Corporation?

Ms Panuccio: News Australia Holdings is 100 per cent ultimately owned by News Corporation, which is an American company.

Senator MILNE: So it is a 100 per cent subsidiary of that. What I am interested in is where the News Australia Holdings accounts, if you like, are domiciled.

Ms Panuccio: We are required under the corporations law accounting standards and ASIC's to lodge consolidated accounts for News Australia Holdings within Australia, which we do.

Senator MILNE: So the only other entity where any money is transferred from News Australia Holdings is back to the parent company?

Ms Panuccio: The majority of our companies are consolidated under News Australia Holdings, and we lodge consolidated accounts for those. We do have other sets of accounts that we lodge outside of that. For instance, we have a business that has been acquired, Eureka. It is a small company, it has a licence and, therefore, we have to lodge accounts for that. There are other accounts outside of the group, but the bulk of the assets, both publishing assets and also our REA, Foxtel and Fox Sports investments, sit under News Australia Holdings. It is complicated because we have two pillars within Australia. When we separated back in 2013, there were effectively two pillars that were set up for the Australian entity—one being News Corporation Pty Ltd, which holds the publishing assets, and one being News Australia Holdings, which holds the non-publishing assets. It includes News Limited, which was the original trading company before we re-domiciled back in 2004. News Australia Holdings has the power to appoint the board for News Limited and News Limited has the power to remove the board from News Corp Australia Pty Ltd.

Basically, what all that means is that we have an ASIC instrument whereby we can consolidate the whole group for Australian purposes. So those accounts that you see for News Australia Holdings include predominantly the publishing assets and also the non-publishing assets. It is very complicated, I know.

Senator MILNE: Do you have the same company that audits all your accounts?

Ms Panuccio: Yes, Ernst & Young.

Senator MILNE: Just to be clear, was $4½ billion repatriated last year?

Ms Panuccio: Yes, $4½ billion has been repatriated, but it has happened in two years—not in cash.

Senator MILNE: I understand that. I will come to how it was split up and repatriated, but I just want to establish that $4½ billion was repatriated.

Ms Panuccio: Yes, and it is in our accounts.

Senator MILNE: Repatriated to which company?

Ms Panuccio: To the US company.

Senator MILNE: To the US parent company. What did that $4½ billion consist of?

Ms Panuccio: It was made up of two transactions across two years. So $3.2 billion of it related to 2013, which was not cash, and that effectively was a transaction that resulted from the separation of the two companies back in 2013, which Julian referred to. Yes, it was a reduction in our equity value here, but it was a movement of shares—effectively shares that belonged to the company that is now called 21st Century Fox. There were no tax implications on that transaction.

Senator MILNE: Before we get to that, I want to know what made up the $4½ billion over the two years. You have only given me part of it.

Ms Panuccio: The second transaction happened in 2014, and that was cash. That was $1.3 billion. The two of those combined make up the $4.5 billion. The $1.3 billion involved the repatriation of the FX refund that we received, which was $623 million plus interest—so, all up, $838 million. Upon separation of the two companies, there was an agreement between 21st Century Fox and the now News Corporation, which we sit under, that, if we won that case, that money would be repatriated back to 21st Century Fox. So that was a big chunk of it. We also had surplus cash here in Australia, so we repaid borrowings to the tune of about $210 million, in addition to transferring surplus cash to the parent company.

Senator MILNE: I now want to go to the issue of the $7 billion in intangibles that has been talked about. Can you explain to me how the transaction which threw up the $7 billion in intangibles, and therefore expanded News Australia Holdings's capital base by the same amount, does not actually amount to the generation of internal goodwill?

Ms Panuccio: Again, it is very complex, and you will have to forgive me, because this happened some 10 years ago and I was not involved in the transactions. But, based on my understanding in preparation for this session today, upon the re-domicile of the company back in 2004, a lot of very complicated accounting transactions arose. Under Australian GAAP accounting standards at the time in 2005, $7 billion of internally generated goodwill was recorded within our books and accounts. When we transitioned to Australian IFRS, different accounting standards, that accounting entry was reversed. That happened in 2006. So, yes, there was an accounting transaction that happened, but it did reverse in 2006.

Senator MILNE: But the inflated share capital remained, didn't it? So, while the decision was reversed, that inflated value remained and users now use that share capital to return billions in cash years later. Isn't that what has actually happened—that you inflated that in order to do that?

Ms Panuccio: No, I do not agree with that.

Senator MILNE: Well, explain to me why that did not happen.

Ms Panuccio: I do not agree with that on a couple of points: (1) when the company reincorporated over into America back in 2004, the directors here in Australia had an obligation to ensure that that transaction happened at fair value, which they did. That was booked through the accounts at the time. In relation to your question—

Senator MILNE: Who determined that was fair value?

Ms Panuccio: I was not around, but independent experts would have at the time. It was, from what I understand, very, very public. We had a tax ruling on it. We had to go to the courts to get a scheme of arrangement in order for that transaction to happen. I would imagine, as part of that transaction, of course there would have been independent valuations. But, to your question of repatriating cash back through the reduction of equity, what I would say is this: as Julian has alluded to earlier in his comments, the profits that we make in

Australia—and predominantly the majority of those profits are made in Australia—are taxed in Australia. Just because we repatriate cash does not mean we have to pay tax on that cash that we repatriate.

I think the other allegation is declaring dividends as opposed to reducing the share capital. There is a tax treaty with the US that effectively has withholding tax at 15 per cent. Because our company is owned 100 per cent by an American entity that withholding tax is reduced to zero. So even if we had have declared a dividend in relation to those moneys, we would not have to pay tax under the tax treaties.

Senator MILNE: I want to come back to the point I was making about the generation of internal goodwill. Was that not precisely what this whole business of throwing up this $7 billion in intangibles and expanding News Australia Holding's capital base purely for the purposes of, essentially, avoiding tax in the long term?

Mr Clarke: No.

Ms Panuccio: No.

Mr Clarke: You have clearly not understood what we have just said.

Senator MILNE: Well, you tell me why it does not infringe part IVA of the tax act?

Mr Clarke: I think we just explained that. Run it again, Susan.

CHAIR: Just before that, we are running out of time and we do have a further witnesses.

Ms Panuccio: Very quickly, since 2004 the ATO have examined those transactions very carefully and have deemed that it did not run foul of part IVA, anti-avoidance. Secondly, a reduction in capital and repatriating cash is not a tax avoidance scheme; it is a perfectly acceptable transfer mechanism for cash. We pay tax on the profits that we produce in Australia. We do not pay tax on cash; we pay tax on profits. As I said, irrespective of all that, even if we had have repatriated the cash via dividends, the tax treaty that exists between the US and Australia and the fact of how our ownership is organised would suggest that we do not have tax to pay because it is at zero per cent. I am not sure what else I can say on that.

Senator MILNE: I respect the fact that the chair wants to bring this to an end, but could you explain how it is that more than a dozen subsidiaries of News Australia Holdings do not file accounts and have no exemption from ASIC? Why not?

Ms Panuccio: I do not agree with that. First of all, we do file accounts under News Australia Holdings, which is a consolidated group of our accounts. They are listed in the closed group within the statements that we file. We have an instrument from ASIC which allows us to do that. I do not accept that we do not file the accounts that we are meant to.

Senator MILNE: So who makes the decision that you do not file those accounts in those separate companies?

Ms Panuccio: They are consolidated under News Australia Holdings, so we are entitled under the regulations to file the accounts in that way.

Senator MILNE: What is the exception you have from ASIC?

Ms Panuccio: It is an instrument. We apply to ASIC and we do so each year. I cannot tell you the number of the instrument that they have given us, but they effectively agree that we can lodge our accounts that way.

Senator MILNE: Okay. If you could take on notice to provide the details of the ASIC exemption?

Ms Panuccio: Yes.

CHAIR: I am very conscious of the time, but I do have some questions. Mr Clarke, I acknowledge that your report and your submission are perhaps the most detailed of a lot of submissions we have been given. Many companies' submissions effectively say that they have not broken any Australian laws, which we were never accusing anyone of, and then they provided as little information as possible. I note you went above and beyond and provided a lot. According to your own figures, your effective tax rate is negative in some years, but your submission says you pay tax in those years. I am a layman here and I do not quite understand how you can have a negative tax rate and be paying tax.

Mr Clarke: Over to Susan, if I may.

Ms Panuccio: It comes back to what Julian was saying about the difference between accounting and tax concepts. If you look at the table that hopefully you all have in front of you—and let's refer to a simple year, 2012—you will see that we had an intangible impairment in the accounts of $686 million. We had an accounting profit before that of $228 million; therefore, giving us a negative accounting profit of $457 million. The reason that we booked that impairment is that under the accounting standards we are required to look at the carrying value of our assets.It has been pretty well documented that the media industry has been going through a pretty turbulent time. As a result, there has been a lot of write-down of those assets. That is an accounting entry. We

have to book it for accounting purposes. The effective tax rate is a formulaic method whereby you take your tax expense and you divide it by your accounting profit. If your accounting profit is negative, by default you get a negative effective tax rate.

CHAIR: We had the three big tech companies here—Google, Apple, Microsoft. We were asking them questions about the allegations that are out there in the media about tax minimisation through jurisdictions. I read through your report. I read through some media reports. I just want to get an understanding: your operations are either between Australia and the US. Is that it?

Ms Panuccio: We do have some interactions with the UK.

CHAIR: But we are not talking Bermuda, Singapore, Hong Kong or Ireland?

Ms Panuccio: No. In relation to this question, we have had a look, since the time that we have been with the company, and we do have seven companies that would operate in what you would call tax secrecy jurisdictions. Six of those companies relate to REA, our real estate business. Three of them sit in Luxembourg—they are trading entities in Luxembourg; they have the number one real estate site there—and three of them sit within Hong Kong and, likewise, they have a business. The final, or the seventh one, we have identified was acquired as part of the CMH acquisition that we did in 2013 or 2012. It is dormant, and it has been dormant ever since, so we are in the process of deregistering it.

CHAIR: The Tax Justice Network, who had some of their representatives here this morning—they are going to be in Melbourne on Friday—have called for quite a bit about secrecy jurisdictions, and they have obviously quite strong views on that. You are saying, from a News Corp perspective, that REA, one of your subsidiary—is REA 100 per cent owned by News Corp?

Mr Clarke: No. 62 per cent.

CHAIR: A company that you own has an operation, but that is it apart from one other that is dormant?

Ms Panuccio: In relation to the News Corp business, yes.

Mr Clarke: They have businesses in Luxembourg and also in Hong Kong.

CHAIR: Do you have a view on secrecy jurisdictions?

Mr Clarke: I think it is an issue for businesses. It is too easy to divert money. But what I am saying is we are not doing that. Here in News Corp Australia, the taxes being paid in other areas is in fact the businesses operating in those other areas.

Ms Panuccio: To come back to your point, for News Corp Australia 98 per cent of the revenue and the profits are generated within Australia, which we pay tax on.

CHAIR: Mr Clarke, are you here today saying that we have to have another look at the GST tax treatment of online? Do you want to just expand on that a bit.

Mr Clarke: GST is an issue for the tax base, anyhow. No doubt you have already dealt with that.

CHAIR: But this online issue, which you touched on earlier.

Mr Clarke: I am not the first to say it. It is affecting retailers as well—goods and services—so it should be applied. If the GST is not applied here and it allows a foreign company to come here and operate on a cheaper operating cost base, then clearly it is not a level playing field.

CHAIR: The example that you are currently facing is the Netflix example. I guess it is too early to tell, but is that having a significant impact?

Mr Clarke: It is too early to tell. They only launched a few weeks ago. But, clearly, when you are selling something at a dollar less than the opposition, you have a distinct advantage, which is what is happening there.

CHAIR: You are saying the system has been geared against you?

Mr Clarke: If the GST was applied to them as it is to us, there would be a level playing field. If they choose to have a price cheaper than us given they are paying all the costs, then that is a different decision, but clearly they are not. They have an advantage now which is unfair.

Senator CANAVAN: Very quickly—and I am following up on your questioning there, Chair—I just want to clarify something. If I click on an ad on your Australian website, the revenue you earn from that ad is reported in your consolidated tax filing with the ATO—

Mr Clarke: GST is applied. The advertiser pays the GST.

Senator CANAVAN: I do not think you were in the room earlier, Mr Clarke, but my understanding of the evidence from Google is if I click on an ad on the Google news website, which is a bit of a competitor to yours in

some respects, they would not report that income in Australia. It is reported in another jurisdiction. They certainly do not pay GST on it as well. If I am clear from your evidence you are saying it is an unfair advantage.

Mr Clarke: It is $2 billion of unfair advantage. We estimate them writing about $2 billion of advertising revenue in Australia. That is a big figure for any media company to be writing in advertising revenue in one year.

CHAIR: So that $2 billion does not get reported here; it gets reported in Singapore. That is from the evidence they were giving. I am very conscious of the time. I thank you, Mr Clarke and Ms Panuccio. Thank you again for your submission.

MAKAS, Mr Manuel, Director and Head of Real Estate, Greenwoods & Herbert Smith Freehills

MIHNO, Mr Andrew, Executive Director, International and Capital Markets, Property Council of Australia

MORRISON, Mr Ken, Chief Executive Officer, Property Council of Australia

[16:16]

CHAIR: I welcome representatives from the Property Council. I note that you were a late addition. I especially want to thank Mr Mihno, who was here this morning as well, bright and early, and has gone through a whole day of listening to the Senate hearing. I appreciate that and I appreciate you coming with short notice. Mr Morrison, I invite you to give a very brief opening statement. The committee hearing starts again in Canberra tomorrow and a few people, including the secretariat, have flights they need to catch.

Mr Morrison: No problems. We made a submission to the inquiry. We understand that the inquiry has some questions for us in relation to stapled securities in particular. I will make a few opening statements if I may.

CHAIR: If you can also in doing that explain it.

Mr Morrison: Yes, that is what I am doing. First up it is worth noting that the property and construction industry is currently one of the major drivers of Australia's economic growth. Property construction currently represents 11.5 per cent of GDP—that is about one-ninth of economic activity in Australia at the moment. We employ 1.3 million Australians, which is more than manufacturing and mining combined. Property is actually the largest collective taxpayer, contributing $34 billion in real estate specific taxes alone—that is before you add income tax, GST, corporate tax et cetera. Indeed, the recent tax reform discussion paper notes that taxes on property in Australia comprise around nine per cent of GDP versus an OECD average of around five per cent.

I will talk about property trusts now before we move to stapling. This economic performance has been achieved in part through the use of efficient tax compliance securitised investments called real estate investment trusts or REITs. Nearly 12 million Australians have investments in REITs either directly or indirectly through their retirement savings vehicles. Australian REITs are simply unit trusts that invest in real property. Australia has been an international leader in developing REITs, which are now common around the world. Australia's property trust rules are designed to help Australians invest in property assets they could not afford to own in their own right and broaden their investment portfolio to reduce the risk from market downturns and to benefit from the market experience and insights of professional asset managers.

Australia does not have a special tax regime solely for property unit trusts. Listed property trusts will typically be managed investment trusts, or MITs, for Australian tax purposes. Under a unit trust, investors pay tax directly on their share of the passive taxable income of the trust. This tax is paid by assessment for Australian resident investors, and that can be as high as 49 per cent, depending on the personal income tax rate of the individual or, secondly, through withholding taxes, for non-Australian resident investors, and that is at tax rates of either 15 or 30 per cent, depending on the country of the non-resident investor. I am happy to talk more about that. This flow-through tax treatment is consistent with common practice among the global REIT regimes around the world. The policy objective here is to put unit trust investors in the same tax position as if they had invested directly in the property themselves. That is a very important, fundamental policy objective.

Turning now to stapled securities, property trusts use a staple structure where they have a mix of activities that need to be separated because they are taxed differently. Passive rental investment activities like property investment—just collecting the rent out of office buildings or shopping centres et cetera—are typically conducted under a trust, with income taxed in the hands of the investor, as I said, up to 49 per cent, depending on the personal income tax rate of the investor themselves. Active trading activities such as development for sale cannot be done in that passive investment vehicle. They need to be done in a company, with the income tax at the company rate of 30 per cent. For Australian REITs, staples are simply a company share and trust unit stapled together. The staple ensures that there is a clear separation between the passive rental income streams, typically in a trust, and the active trading activities, typically in a company. All tax is paid to the government, but the tax on the passive rental income is paid directly by the investor as income tax.

It is important to note that stapled securities exist in other jurisdictions around the world. However, for REITs outside Australia, staples are largely unnecessary, because other countries have regulations which allow investors to achieve the same result using a different structure. Again, I am happy to come back to that in questions. For example, in the USA, REIT staples are unnecessary because US investors can use a taxable REIT subsidiary instead, which separates out the different types of income, using a company subsidiary. That is not a structure that is available in Australia.

Just to conclude, Australia has a robust tax system, and the integrity measures have recently been reviewed. These are in line with standards adopted in other developed countries. For example, the thin capitalisation 'safe harbour' limit has been reduced from 75 per cent to 60 per cent. Australia also has a very broad and effective general anti-avoidance rule, part IVA, which has only recently been further tightened. Australia's tax treatment of property trusts is consistent with international guiding principles for collective investment vehicles and REITs in particular. Both the Australian Board of Taxation and the OECD have recognised the critical importance of having tax flow through collective investment vehicles.

Thanks once again for having us here. I am happy to take any questions you might have.

ACTING CHAIR (Senator Canavan): In the absence of the chair, are there any senators who have questions? I have some questions.

Senator MILNE: You go ahead.

ACTING CHAIR: Thank you, Mr Morrison, for your submission. It is very useful. This is a simple factual question, I think. You say there that the net rental income from the managed investment trust, or MIT, flows annually to the investor. Can I just clarify that there is not the ability in these trusts to maintain or retain the earnings from year to year and then pay it out later? The rental income earnt, if you like, in one tax year has to be paid in that tax year to the investor?

Mr Makas: Let me clarify that. You can actually retain, but the law acknowledges that, and tax is paid by the unit holders on the taxable income each year, irrespective of the amount distributed.

ACTING CHAIR: So it is effectively paid and then reinvested?

Mr Makas: It is paid and there are integrity rules around that.

ACTING CHAIR: You do not physically have to do that? You do pay tax on it, basically, every year?

Mr Makas: Yes, every single year.

ACTING CHAIR: There is not an ability to defer tax through the trust fund?

Mr Makas: Yes.

ACTING CHAIR: That is clear. On the REITs, the stapled structure, I am just trying to work out what the policy rationale is for having these vehicles. Couldn't we simply have a property trust as a corporation and with our imputation credit system the trusts of the individual investors would still receive franked dividends and not necessarily need this separated structure. Why do we have this separated structure?

Mr Morrison: I will start and let others take over. The starting point is having equivalent tax treatment to owning property directly. Collective investment vehicles have that equivalent tax treatment, so that if I owned a property directly then I would be paying tax on the passive rental income streams at my rate of tax. So the flow-through taxation arrangements for collective investment vehicles are given an equivalent status where the tax is paid by the individual, but it limits that to passive income. So where you have an entity which has active income streams, like development or other active income streams, then that active income cannot be in that trust otherwise it trips that over and forces the income to be—

ACTING CHAIR: The income from those investments gets taxed at the 30 per cent rate?

Mr Makas: No, the whole entity would then be taxed at 30 per cent.

ACTING CHAIR: Okay.

Mr Morrison: So the stapled structure allows the active income streams to exist within a company and to pay tax at that corporate level of tax rate and the passive income flows—rent, basically—exist in that flow-through tax structure that I described. The rationale for that is that that is a tax equivalent of owning directly. So you start with what is the rationale for a collective investment vehicle and a tax flow-through status. As I said in the opening statement, that is the common international practice. It has been reinforced by multiple reviews at multiple times by successive governments. It is an uncontroversial, well established international policy of having a tax flow-through status there. But in Australia that can only be passive income that is in there.

ACTING CHAIR: How many REITs do we have and what would be the total capitalised value?

Mr Mihno: I do not have that information on me. We can come back to you with that.

Senator KETTER: There has been some suggestion that trust structures, particularly stapled securities, offer opportunity for tax arbitrage in Australia. Would you like to comment on that?

Mr Morrison: We do not see an opportunity for tax arbitrage. Because you have on the passive income flow side a tax equivalent status between owning property directly and owning it through a collective investment

vehicle, you have equivalency there. The tax is being paid by the unit holder at their applicable rate of tax, which could be up to 49 per cent for an individual. So the tax is being paid. It is not being paid by the trust entity; it is being paid by the individual. The tax on the corporate side is being paid at that corporate level of taxation.

The other thing that is useful to bear in mind the integrity measures which are in place, and I might let Manuel talk to some of those integrity measures which protect that.

Mr Makas: Yes, there are integrity measures and the ATO have been prepared, where they have felt those integrity measures should be invoked, to do that and they are about to be further strengthened as well when we bring through the new MIT rules, which are imminent.

Senator KETTER: In terms of these REIT structures, how does the Australian structure differ from structures in other countries such as the US and the UK where stapled securities are not permitted?

Mr Mihno: To our knowledge, stapled structures are permitted in other countries, but the different regulations, as we pointed out before, mean that staplings may not actually be required; they have a different way of dealing with it. So, for example, for the US, stapling is not required because US trading activities—again, separating out—can be undertaken by the taxable REIT subsidiary. That basically means that, in Australia, we have said that we have got tradeable activities that are going to be taxed at 30 per cent and we have got the flow-through passive rental, which is taxed at the individual's rate. You have to keep those separated into different vehicles. In America, all they have said is, 'Just keep track of which ones are tradeable and which ones are passive and you can keep them in the same vehicle.'

Senator KETTER: Moving on, do you think there are issues with the transparency of privately held property trusts?

Mr Mihno: It depends what you actually define as 'privately held'. If you are talking about family discretionary trusts, they are not actually within our bailiwick. That is not who we are talking about. When we talk about REITs, we are talking about property unit trusts. These are registered or unregistered managed investment schemes. From that point of view, when we talk about transparency, we see that there is full transparency from the REIT perspective. If you want to talk about private discretionary trusts, that is an entirely different matter, and it is not really within our remit to talk about those. Property unit trustees have a fiduciary responsibility, which basically means that their obligations often extend past what you would expect from even directors duties under Corporations Law. We also have extensive and comprehensive reporting obligations. For instance, investors get financial reports that are prepared on the same basis as companies. They get detailed tax statements which provide a breakdown of the types of taxable income they have and that the trusts have generated. The ATO also gets full details of all distributions made to investors, broken down by type of investor and income.

Senator MILNE: I just wanted to get an understanding from you, if we were to do away with the stapled security structure, of what that would mean for income from superannuation.

Mr Morrison: I guess it depends in part on what you replace it with. If you were to replace it with a US style structure, that is possible. It is not something we have done a lot of homework on, but there is some attractiveness in that type of structure. As Andrew was describing, you still allow the different types of income to be taxed in different ways. It would depend on what the regulatory requirements were around that and how onerous that was compared to the existing structure. Certainly, if the government were to change the tax flow-through status of property trusts, that would have an immediate and devastating impact on Australian superannuants and other investors. It would certainly send a very strong signal to the world that Australia was out of step in the way that we treat this sort of investment, and we certainly would be recommending the Australian government and the Australian parliament not go down that path.

Senator MILNE: I was just interested to get a response on that. One of the issues that has come up in the government's white paper is the issue of dividend imputation and that whole system, asking whether we need to create tax neutrality between different asset types—property and other types of capital assets. I wondered whether you had a comment to make about that.

Mr Mihno: From that point of view, we are in the process of canvassing opinions from the industry on this particular point. However, from our initial reaction, it certainly makes sense for a passive investment income to be flow-through, irrespective of the vehicle. However, if government were to take that and make all company flow-through entities and refer to all incomes, we are not sure that that would work very well at all. One of the important points to remember about dividend imputation is the fact that, as was pointed out by some of the academics earlier today, it does act as an incentive for companies to pay income tax. So it is not really a problem from our point of view; it is an enabler for tax. From that point of view, we think that we will provide further

detail on this, but it is too early to say. It depends entirely upon what it is that you are looking at replacing it with. At the end of the day, I think it is more important that, if we are going to look at dividend imputation, we focus on making sure that we do not end up with a double tax or an unfair treatment. I think that, if you focus on that rather than the integrity measure itself, the integrity will flow from that.

Senator MILNE: Okay, but you will obviously be making a detailed submission in relation to that matter?

Mr Morrison: Correct.

Mr Mihno: On the tax white paper process.

ACTING CHAIR: Thank you, Mr Morrison, and your colleagues. We appreciate your submission. Thank you, everybody, for being here today, including those who have stuck around until the end.

Committee adjourned at 16:35