Perspectives: Future Directions in Corporate Tax

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Overview of presentation

1. State of play for corporate tax reform in Australia
2. BEPS, anti-abuse and transparency
3. How does Australia compare?
4. Trump, Brexit and other international uncertainties
5. Future corporate tax design: new directions?
1. State of play for corporate tax reform in Australia
Corporate tax policy

- Australia’s corporate tax policy development process - short term revenue focus and politically driven integrity measures

- Since 2012 – 17 enacted or proposed tax integrity and tax disclosure measures
## Recent Australian Tax Integrity and Tax Disclosure Measures

<table>
<thead>
<tr>
<th>Measure</th>
<th>Effective Date</th>
<th>Summary of Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Anti-avoidance Schemes</td>
<td>Schemes entered into after 16 November 2012</td>
<td>Strengthening of the definition of tax benefit</td>
</tr>
<tr>
<td>Multinational anti-avoidance law</td>
<td>From 1 January 2016</td>
<td>Prevent the artificial avoidance of permanent establishments</td>
</tr>
<tr>
<td>Thin capitalisation</td>
<td>1 July 2014</td>
<td>Reduction in safe harbour debt limits from 75% to 60% for Non Banks and from 95% to 90% for Banks of Australian Assets.</td>
</tr>
<tr>
<td>Transfer Pricing</td>
<td>For years ending 30 June 2014</td>
<td>Substantial changes to modernise Australian rules to accord with contemporary OECD standards. Requirement for contemporaneous documentation to support positions taken otherwise significant penalties imposed.</td>
</tr>
<tr>
<td>Country by Country Reporting</td>
<td>For tax years commencing on or after 1 January 2016</td>
<td>Requirement to file country by country reports, including master and local files with the ATO in accordance with OECD requirements</td>
</tr>
<tr>
<td>Public tax disclosures</td>
<td>From the 2014 income tax year</td>
<td>ATO to annually publish tax data for publicly listed and foreign taxpayers with over $100m turnover of total income, taxable income and tax paid (including PRRT)</td>
</tr>
<tr>
<td>Filing of general purpose financial statements</td>
<td>For tax years commencing on or after 1 January 2016</td>
<td>Requirement to lodge general purposes financial statements with the ATO</td>
</tr>
<tr>
<td>Tax Exchange of Information Agreements</td>
<td>Various</td>
<td>TEIAs to enable ATO access to information from 36 non treaty country tax administrators, including countries such as Cayman Islands, Luxembourg &amp; Bermuda,</td>
</tr>
<tr>
<td>Reportable tax positions</td>
<td>From the 2014 income tax year</td>
<td>Taxpayers to disclose to the ATO tax positions taken that are not reasonably arguable</td>
</tr>
<tr>
<td>Measure</td>
<td>Effective Date</td>
<td>Summary of Change</td>
</tr>
<tr>
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</tr>
<tr>
<td>Revised International Dealings Schedule</td>
<td>From the 2012 income tax year</td>
<td>Modernisation of related party tax disclosures to the ATO, including details of all related party transactions</td>
</tr>
<tr>
<td>Anti–hybrid rules</td>
<td>1 January 2018 or six months after the hybrid mismatch legislation receives Royal Assent.</td>
<td>Adoption of OECD standards to ensure no double non taxation or double deductions for certain hybrid instruments and structures</td>
</tr>
<tr>
<td>Updated OECD transfer pricing rules</td>
<td>Proposed to apply as from 1 July 2016</td>
<td>Australia to adopt revised OECD BEPS transfer pricing guidance into Australia’s tax laws</td>
</tr>
<tr>
<td>Diverted Profits Tax</td>
<td>From 1 July 2017</td>
<td>40% tax on certain transactions with lower tax jurisdictions to ensure tax is paid in where activities of economic substance reside.</td>
</tr>
<tr>
<td>100-fold increase in late lodgement penalties</td>
<td>From 1 July 2017</td>
<td>A 100-fold increase in penalties for late lodgement of approved forms with the ATO (i.e. $90,000 per month for any approved form).</td>
</tr>
<tr>
<td>Doubling of penalties for false and misleading statements</td>
<td>From 1 July 2017</td>
<td>A 100% increase in penalties for false or misleading statements.</td>
</tr>
<tr>
<td>Revised reportable tax positions</td>
<td>For income years commencing after 1 July 2016</td>
<td>Revised filing requirements for certain transactions that are subject to certain ATO Tax Alerts</td>
</tr>
<tr>
<td>Doubling of penalties for international tax schemes</td>
<td>From 1 July 2015</td>
<td>100% penalty applying to significant global entities for entering into tax avoidance and profit shifting schemes with the dominant purpose of creating a tax benefit. 50% penalty if no dominant purpose.</td>
</tr>
<tr>
<td>Adoption of the OECD multilateral instrument for all tax treaties</td>
<td>Potentially take effect in Australia from 1 January 2019. Signing on 1 July 2017.</td>
<td>Adoption of new BEPS standard for existing treaties including revised PE test, principal purpose test for treaty shopping and mandatory arbitration.</td>
</tr>
</tbody>
</table>
Corporate tax policy and politics, versus administration

Australian Taxation Office – Politics versus Administration

A new Tax Avoidance Taskforce $679m

390 new specialised officers

Budget estimate more than $3.9b in tax liabilities by 2020
2. BEPS, anti-abuse and Transparency

- BEPS project is ongoing
- BEPS measures will be a central feature of future global corporate tax design
- OECD Multilateral Instrument (Dec 2016)
- Australia unilaterally asserting jurisdiction to tax MNEs
  - Multinational anti-avoidance law
  - Diverted profits tax
- Potential conflict with other jurisdictions eg US
Transparency and Cross-Country Cooperation

- Unprecedented cooperation between countries (probably will continue even after Trump/Brexit)
  - Multilateral Convention on Mutual Assistance
  - Updating bilateral treaties for cooperation
  - Automatic Exchange of Information
  - Automatic Country by Country reporting
  - JITSIC and other ATO agency co-operation
  - FATCA with US (reciprocal)
  - Mutual Assistance in tax collection

- Growing transparency demands
  - Public corporate tax transparency (Aus; CbC?)
Post Truth Politics and Effect on Policy Debate

- Focus is on winning over the populist view rather than on where Australia’s tax system should be heading

“A simple lie is easier to sell than the complex truth”

“679 major corporations and 54 millionaires paid no tax whatsoever. It's time for the Coalition to get their priorities straight.”

Source: Getup! Facebook page 16 January 2017
In Australia: company tax revenues trending up until recently

Corporate taxation as a percentage of GDP
Australia’s “effective” company tax rate is close to statutory rate
Medium to long term policy agenda

- Australia needs a framework to guide corporate tax policy decision making (UK and NZ)

- Effective tax policy making process breeds greater confidence in the tax system
## Tax Policy Comparison Table as at 23 January 2017

<table>
<thead>
<tr>
<th>Policy</th>
<th>Detail</th>
<th>Coalition</th>
<th>Labor</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Corporate Tax</strong></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Rate</td>
<td>Reduce to 27.5% for businesses less than $10m from 1 July 2016, phasing in for companies over $1 billion to 25% over 10 years by 2026-2027</td>
<td>Retain 30% rate, 27.5% for small business less than $2m from 1 July 2016.</td>
<td></td>
</tr>
<tr>
<td>Thin capitalisation</td>
<td>No change to thin cap. Retention of 60% Australian asset, world wide gearing and arm's length debt tests</td>
<td>Remove arm's length debt test and 60% Australian asset test and only have world-wide gearing ratio. (unclear if this is still policy)</td>
<td></td>
</tr>
<tr>
<td>Anti-hybrids</td>
<td>Implement OECD standard to deny deduction if non assessable in foreign jurisdiction</td>
<td>Implement OECD standard to deny deduction if non assessable in foreign jurisdiction</td>
<td></td>
</tr>
<tr>
<td>Public tax transparency</td>
<td>Retain public tax transparency at $200m for private groups</td>
<td>Reduce threshold to $100m for private groups</td>
<td></td>
</tr>
<tr>
<td>Voluntary Tax transparency code</td>
<td>Adopt Board of Tax (BoT) recommendations</td>
<td>Adopt BoT recommendations. Some indication code to be mandatory.</td>
<td></td>
</tr>
<tr>
<td>Diverted profits tax</td>
<td>Implement DPT with effect from 1 July 2017</td>
<td>No announcement yet, but likely</td>
<td></td>
</tr>
<tr>
<td>Penalties</td>
<td>Increase late lodgement penalties to 100 penalty units per month ($450,000 maximum) for all lodgments of approved forms for large taxpayers. Doubling of penalties for false and misleading statements</td>
<td>Increase to maximum of 125 penalty units per month for CbC reporting ($270,000 maximum). ATO must consider an examination if not received within 12 months. No other changes to penalties at this stage</td>
<td></td>
</tr>
<tr>
<td>2015 OECD guideline rewrite</td>
<td>Implement as from 1 July 2016, including profit split methodologies at a later date to be determined (expect 1 January 2017)</td>
<td>Likely to agree to implement as from 1 July 2016, including profit split methodologies at a later date to be determined (expect 1 January 2017)</td>
<td></td>
</tr>
<tr>
<td>Mandatory disclosure regimes</td>
<td>Implement OECD recommendations</td>
<td>Implement OECD recommendations</td>
<td></td>
</tr>
<tr>
<td>Consolidation</td>
<td>Deductible liability and deferred tax are netted off asset values as part of cost setting calculations. Securitisation changes</td>
<td>Unknown at this stage. Maybe be some resistance given original proposal was Labor policy.</td>
<td></td>
</tr>
<tr>
<td>Whistleblower legislation</td>
<td>Implement protections for whistleblowers, possible financial rewards.</td>
<td>Unknown but likely</td>
<td></td>
</tr>
<tr>
<td>ATO Tax task force</td>
<td>$700m over 4 years, $3.9billion target. Panel of Judges for settlement</td>
<td>Unknown but very likely as part of budget appropriations</td>
<td></td>
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</table>
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<tr>
<td>Personal Income Tax</td>
<td><strong>Negative gearing</strong> Retain negative gearing across all asset classes</td>
<td>Negative gearing for new residential builds only as from 1 July 2017. All other investment losses to be quarantined. Grandfather existing negative gearing for assets acquired before 1 July 2017.</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Capital gains</strong> Retain 50% discount for individuals and 33% discount for super funds</td>
<td>Reduce discount to 25% for all assets acquired after 1 July 2017. Super funds retain 33% discount.</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Rate</strong> Adjust 37% threshold of $80,000 to $87,000. Remove 2% budget repair levy for income over $180,000 from 1 July 2016</td>
<td>Adjust 37% threshold of $80,000 to $87,000. Retention of 2% budget repair levy for income over $180,000</td>
<td></td>
</tr>
<tr>
<td>Superannuation</td>
<td><strong>Contributions</strong> Those on income (plus super) above $250,000 have contributions tax increased to 30% (from 15%)</td>
<td>Those on income (plus super) above $200,000 have contributions tax increased to 30% (from 15%)</td>
<td>Effectively income on balance up to $1.6 million (in pension stage) tax free, 15% on amounts above that.</td>
</tr>
<tr>
<td></td>
<td><strong>Tax rate</strong> Effectively income on balance up to $1.6 million (in pension stage) tax free, 15% on amounts above that.</td>
<td>Income from super less than $75,000 remains tax free, income over $75,000 taxed at 15%.</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Non concessional contributions</strong> $100,000 per annum cap</td>
<td>$75,000 per annum cap</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Maximum concessional contributions</strong> $25,000 per annum regardless of age</td>
<td>$25,000 per annum regardless of age</td>
<td></td>
</tr>
<tr>
<td>GST</td>
<td><strong>Rate</strong> 10%</td>
<td>10%</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Base</strong> No change</td>
<td>No change</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Low value goods (less than $1,000)</strong> Yes from 1 July 2017</td>
<td>Yes from 1 July 2017</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Non resident intangible supplies (now law)</strong> Yes from 1 October 2016</td>
<td>Yes, 1 October 2016</td>
<td></td>
</tr>
</tbody>
</table>
Turnbull Govt Enterprise Tax Plan

- Company tax rate from 30% to 25% by 2026-27
  - Gradually lowering rate and increasing turnover thresholds, starting with small businesses

- Bill in the Parliament, *but*
  - Highly contentious; unlikely to pass the Senate
  - We will have a lower rate for small companies immediately but the prospects for large companies in future is not clear.
  - Corporate-shareholder dividend imputation system; lower rate reduces immediate value of franking credits

- Contested as regards
  - Economic benefits (nb. Modelled growth effects)
  - Fiscal impact
  - Fairness
The fiscal challenge MYEFO 2016-17

Chart 3.2: Structural budget balance estimates

Per cent of GDP

Forward estimates / projections period

Medium-term projections period

Structural budget balance balance band
Underlying cash balance
Structural budget balance

Per cent of GDP

3. How does Australia compare?

- Reliance on corporate revenue in Australia unprecedented and dangerous

- Standing still - inefficient taxes and an uncompetitive headline rate

- Tax competitiveness is a dynamic process – we cannot stand still
Australia collects more company tax than most other countries (% of GDP)

OECD (2016) % of total taxation – 2014 data
Company tax all-in rate % (2016)

OECD (2016)
Company tax rates (2000 to 2014)

Competition versus Prostitution
4. Trump, Brexit and other international uncertainties

- Trump – lower rate, broader base and border tax
- Congressional Republicans – lower rate, cashflow tax, border tax
- Brexit – keep it simple but also anti-abuse
- Europe – hold the fort?
Brexit – UK action?

- Theresa May is keeping it simple and cheap...

- But, at the same time, UK enacting ever-more complex BEPS anti abuse laws
Meanwhile, in the European Union – Holding the fort?

- BEPS, Anti-abuse package even stronger than OECD!
- Ireland – a tax/trade war with the US?
- Trying to build a common approach to corporate taxation
- Moving towards a minimum corporate tax base?
- Common Consolidated Corporate tax Base (CCCTB)
- Financial Transactions Tax
Apple, Ireland (and... the US)

State aid: Ireland gave illegal preferential tax treatment to Apple

Almost all profits allocated to head office existing only on paper and left untaxed

Almost no profits taxed in Ireland (0.005% effective tax rate in 2014)

Payments to Apple Inc. (US) to finance R&D

All profits from European sales recorded in Ireland

Trumped?

Trump Corporate Tax Plan

- Reduce company tax rate from 35% to 15%
- Repeal corporate alternative minimum tax
- Allow firms doing manufacturing in U.S. to choose between full expensing of capital investment and interest deductibility of interest
- Eliminate various business deductions and credits, except for the R&D credit.
- Impose a one time “deemed repatriation tax” of 10% on profits of foreign US subsidiaries, payable over 10 years
- Include future profits of US foreign subsidiaries on accrual basis (remove foreign subsidiary CFC “loophole”)
- **Tariff wall; border tax**: An unspecified tax on imports….
US House Republications

Destination based cash flow corporate tax

- Reduce company tax rate from 35% to 20%
- Tax income of pass-through business at maximum 25%
- Repeal corporate alternative minimum tax
- Allow cost of capital investment to be expensed
- No deduction for net interest expenses on future loans
- Restrict deduction for net operating losses to 90% of net taxable income, allow indefinite carry forward with inflationary uplift (eliminate carryback)
- Repeal most business tax concessions except R&D credit
US House Republications

- Fully territorial tax system exempts 100% of dividends from foreign subsidiaries
- One time deemed repatriation of currently deferred foreign profits, 8.75% tax rate for cash and cash-equivalent profits; 3.5% on other profits.
- **Border adjustment:** Disallow the cashflow deduction for purchases from nonresidents; exempt export profits and foreign-derived profits from taxation
But path of US tax reform won’t be smooth...

Donald Trump criticizes House Republicans’ tax plan: WSJ

CNBC.com staff | @CNBC
Monday, 16 Jan 2017 | 10:35 PM ET
5. Future directions for corporate tax

- Lowering company tax rate is inevitable but slow

- Can the company tax base be broadened?
  - Domestic cupboard bare?
  - Tightening interest deductibility
  - Reviewing the Holy Grail: Dividend imputation
  - Carry-forward losses

- Other developments nationally?
  - Research and Development Tax Incentive – under review; venture capital measures
  - Asset depreciation, investment allowances?
Selling the need for reform

- Politics and publicity

- Corporate tax reform and corporate tax avoidance hurdle
Selling the need for reform

- Who will benefit most from corporate tax reform?
- Large companies pay the most corporate income tax

<table>
<thead>
<tr>
<th>Size</th>
<th>Companies</th>
<th>%</th>
<th>Net tax $m</th>
<th>%2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loss</td>
<td>1,672</td>
<td>0.2%</td>
<td>4</td>
<td>&lt;0.1%</td>
</tr>
<tr>
<td>Nil</td>
<td>123,390</td>
<td>13.9%</td>
<td>61</td>
<td>0.1%</td>
</tr>
<tr>
<td>Micro</td>
<td>686,067</td>
<td>77.3%</td>
<td>7,664</td>
<td>11.5%</td>
</tr>
<tr>
<td>Small</td>
<td>58,212</td>
<td>6.6%</td>
<td>6,886</td>
<td>10.3%</td>
</tr>
<tr>
<td>Medium</td>
<td>15,623</td>
<td>1.8%</td>
<td>8,579</td>
<td>12.8%</td>
</tr>
<tr>
<td>Large</td>
<td>1,299</td>
<td>0.1%</td>
<td>3,355</td>
<td>5.0%</td>
</tr>
<tr>
<td>Very large</td>
<td>1,086</td>
<td>0.1%</td>
<td>40,338</td>
<td>60.3%</td>
</tr>
<tr>
<td>Total</td>
<td>887,349</td>
<td>100.0%</td>
<td>66,887</td>
<td>100.0%</td>
</tr>
</tbody>
</table>
Selling the need for reform

- A robust tax environment under which corporates pay their way

  PLUS

- An environment that encourages businesses to grow and prosper

  EQUALS
Global context for corporate tax is volatile
- There is a risk of tax/trade wars

But, global trends are to lower headline rates
- how long can Australia be an outlier?

Need to focus corporate tax policy for longer term
- Lower rate, broader base? (CBIT?)
- Destination cash flow or consumption base for company tax?
- Allowance for corporate equity (ACE?)
- Making sure we tax our resources base better
Concluding Comments - Michelle

- Less reliance on more damaging taxes
- Compensation is key but must be distinguished from entitlement
- BEPS and transparency – driving global changes to corporate tax systems
- Reducing the corporate rate – not a zero-sum gain
- Economic reform will come from strong leadership or a crisis

Which will Australia choose?
Thank you

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