

LARGE BUSINESS

FINANCIAL
EXECUTIVES
INTERNATIONAL OF
AUSTRALIA

UNCLASSIFIED

24 JULY 2008

SEGMENT

AUDIENCE

CLASSIFICATION

DATE



Australian Government

Australian Taxation Office

Large business tax risks and opportunities

Speech by Michael D'Ascenzo, Commissioner of Taxation,
Financial Executives International of Australia
Melbourne, 24 July 2008

Nearly two years ago the ATO held a symposium with large corporates. It was ambitious and aspiration in intent, but not unrealistic. It was one of a number of steps taken to build a more open and productive relationship with the large business community. It was an invitation to move to more collaborative approaches. If there is one message from today, it is to reiterate that invitation.

With the symposium, we released our [Large Business and Tax Compliance](#) booklet which provides good guidance on what tax risk looks like from our perspective. The booklet, which is akin to a charter, is frequently cited back to us by taxpayers.

We have continued to listen to large companies, building on our consultative arrangements with new forums aimed at practical solutions¹.

Our program of meetings with senior executives of the largest corporates (the top 100) is going well with 84 corporates having participated so far.

We co-designed the process for priority rulings with corporates to help meet the timeframes of large business. Its features of early and open engagement have helped drive improvements in timeframes for all of our advice work.

We have worked towards resolution of old audit cases that have dragged on for too long, and our policy to remit interest accruing after more than two years reflects the seriousness of our commitment.

We have a growing range of forward compliance products to provide more of the real-time certainty that large business tells us they value most.

While we are seeing a growth in complex global tax structures we are also witnessing a growth in requests for private binding rulings on many of the associated tax issues. It indicates that many large companies are as anxious as the ATO to ensure enhanced and ongoing dialogue, whatever the new complexities.

These trends are consistent with the recommendation of the OECD's Forum of Tax Administration for an "enhanced relationship" with large business.² They are also consistent with a recent CEO Survey that found:

'CEOs, operating - as they are – in an increasingly connected world, regard collaboration as a source of business success and that this also extends to public/private sector relationships.'³

1 I announced a new Large Business Advisory Group on 12 May 2008, along with workshops to promote greater communication between the ATO and large corporates.

2 OECD Cape Town Communiqué, Fourth Meeting of the OECD Forum on Tax Administration, 11 January 2008.

3 PricewaterhouseCoopers' Regulate and Collaborate 'What is success in a connected world?' p3 However more work remains to be done : see p22. The ATO recognises that there is room for reasonable differences of opinions in relation to novel arrangements.

Building Community Confidence

Community confidence exists where there are high levels of voluntary compliance and where the administration of the tax laws is fair and accountable. Community confidence and proper administration in turn promote higher levels of voluntary compliance.

To support high levels of voluntary compliance we use a risk management approach that seeks to address the causes of non compliance with appropriate responses.

Essentially we have a tripartite role:

- helping taxpayers and their agents (and advisers) understand their rights and obligations
- making it as easy as possible for people to comply with the law, and
- ensuring effective strategies are in place to deter, detect and deal with non compliance.

Promoting Good Governance

The value, volume and complexity of transactions made by large businesses carry inherent risks for tax compliance.

We promote good corporate governance as the cornerstone for managing tax risk in the large corporate sector.

There are two levels of issues for large businesses to consider. The first is ensuring that basic accounting and control mechanisms are operating to handle the day to day obligations.

The second relates to the tax issues associated with major transactions, arrangements and strategies that would themselves be subject to board, or top management consideration.

In particular, we suggest that directors and senior management may want to:

- be confident that their reporting procedures to identify and escalate material risks, include tax risks
- consider, at least from a financial and business perspective, the tax implications of major transactions, business structures and strategies, and
- be aware of the kind of relationship the company has with the ATO, for example, the stance the business and its advisers adopt in relation to tax compliance and tax planning.

All of these factors have a bearing on whether the large business has a high, moderate or low tax risk level from our perspective.

Unanticipated tax risks may derail the corporate's strategic goals and objectives. Based on current trends, we expect to be making large adjustments through our audit work, suggesting an ongoing need for vigilance on our part and care on the part of the taxpayers and their advisers.

Mitigation Strategies

As I mentioned previously, whether a company has a broad or narrow appetite for risk, the ATO provides companies a wide menu of products to better manage tax risks.

For example, we are now issuing around 300 private binding rulings a year to large companies that provide them with certainty about the tax outcomes of a proposed or completed transaction. On an annual basis we also issue around 20 product rulings, 90 class rulings, and 69 advance pricing agreements (APAs)⁴ to large businesses. We have Forward Compliance Agreements in place with some corporates and are in discussion with a number of taxpayers about our Annual Compliance Arrangement.

For taxpayers that choose to adopt more aggressive strategies, there is a range of graduated responses including reviews, audits and litigation, where appropriate.

It may challenge preconceived notions, but auditing is not a first choice for us – we prefer a prevention is better than cure approach.

Nevertheless we have to consider, and as appropriate deal with material risks.

Using a range of financial and tax-specific indicators, we compare the business performance of a large corporate with their tax outcomes.

Our intelligence and risk analysis systems are becoming increasingly sophisticated. We are becoming more accurate in our case and issue selection.

Consistent with the need to keep up with an increasingly complex environment, including greater cross-border activity, investment and employment activity; the Government has invested additional funds in our income tax compliance work, particularly our focus on large business and high wealth individuals.

The \$700 million increase in funding is expected to deliver an additional \$5.7 billion in revenue over four years. However this includes both the direct and indirect effects of a more holistic approach to managing risks, with significant effort being placed on increasing voluntary compliance.

⁴ This is a voluntary program which enables corporates to agree with the ATO on the transfer pricing of cross-border related party transactions. It gives corporates certainty in transfer pricing risk for typically three to five years.

Recently we conducted a pilot review of 40 corporates across different sectors, with large book-to-tax negative adjustments. Working with their advisers, we sought to get a better understanding of the discrepancies. Preliminary indications are that this is a useful way to mutually identify, mitigate or discount potential risks.

Globalisation

We appreciate that globalisation is creating new frontiers in business evolution.

The ATO is seeing a greater level of complexity in the way that businesses structure themselves, the manner in which business is conducted and the deals that are done to maximise positioning in the global context. Issues like transfer pricing, cross border financing and business restructuring have taken on a more acute competitive emphasis.

The ATO is conscious — and in some cases concerned — that some corporates are restructuring their value chain to move certain functions, assets and risks into more favourable tax jurisdictions, without commensurate benefits to Australia.

We have also seen situations where the way in which a business is structured in terms of its level of debt and equity, the use of inter-group guarantees to create that debt, and how the business model works appear to leave the Australian enterprise with little scope to make profits in Australia.

Some of these issues raise policy considerations and so are ultimately matters for Treasury and Government. However, given the tax implications for Australia, we have a responsibility to see if there is compliance with Australia's laws.⁵

Tax Tips for Executives

Being tax time, you may be interested in an update on our review of public and private company executives, particularly in relation to employee share benefits.

So far we have been reviewing the remuneration and incentives provided to public company directors and executives earning over \$1 million a year.

Some of the taxpayers examined had tax shortfalls related to employee share scheme benefits. While the average adjustment has been approximately \$180,000, there have been shortfalls of over \$2 million, potentially resulting in significant penalties and interest.

⁵ Some of these issues are surfacing as part of APA applications. The ATO has commissioned an external independent review of the APA program.

Where an employee acquires a share or right for less than market value, the discount is considered income and must be included in the taxpayer's assessable income. This is a common mistake – failure to recognise the discount as income and report it on their return.

The alienation of shares and rights to an associate, such as a trust or a spouse, also contributes to tax shortfalls. Many taxpayers believe that the allocation transfers the tax consequences to the associate⁶, however, the legislation still includes the discount in the original taxpayer's assessable income.

If a taxpayer has failed to elect to have the discount on certain shares or rights assessed in the year that they are acquired, the discount is assessable at a later point in time, such as when the shares are sold.

Recent amendments to the election requirements require that from 2008-09, taxpayers who elect to be taxed upfront on the discount must now include the election *and* the amount of the discount in their tax return in the year they acquire the shares or rights. If an election is not made in the tax return, assessment of the discount will be automatically deferred.

In 2008-09 we are continuing our review of public company executives and director remuneration and will expand our focus to privately held companies.

These and other risks we are concerned about will be addressed in our 2008-09 Compliance Program which will be released on 13 August 2008.

Public Perceptions

Reputation and public image are big ticket items for large organisations. They invariably have a critical impact on organisational performance and effectiveness. We've all seen that risks to reputation in a 24/7 information-rich, connected world can inflict swift and lasting blows

The community has opinions and perceptions of both the ATO and large businesses. Attitudes and behaviours can have a discernible impact, acting as either a brake or a catalyst to our respective strategies and goals.

Australians are currently divided in their perception as to whether we are ensuring large companies pay their correct share of tax.⁷

In response to the statement "the ATO is effective in making sure large companies pay their share of tax", 4% strongly agreed and 38% agreed. However 28% disagreed and 9% strongly disagreed. 21% didn't know.

In response to "the ATO is effective in preventing tax avoidance by large companies", 4% strongly agreed and 33% agreed. Slightly more negative than

⁶ refer [Taxpayer Alert TA 2007/4](#) and [ATO Interpretative Decision ATOID 2003/192](#)

⁷ [Community Perceptions Survey 2007](#)

the previous set of responses, 31% disagreed and 10% strongly disagreed. 23% didn't know.⁸

The fact is that large business pays around 42% of tax that we collect, including tax paid by large companies on behalf of employees, FBT, Petroleum resources rent tax and Excise.

Further, Australia ranks third against OECD countries in terms of the ratio of Company tax to GDP⁹, and this occurs even though our corporate tax rate is around the average for OECD countries¹⁰.

What this means is that working together we have some way to go in getting public perceptions right! However perceptions as is often the case do not reflect the facts. So the invitation to take a more collaborative approach is realistic, being made against the backdrop of generally high levels of compliance by most large businesses in Australia.

⁸ Ibid

⁹ OECD Centre for Tax Policy and Administration, 'Tax Administration in OECD and selected Non-OECD Countries: Comparative Information Series (2006)', p98.

¹⁰ Warburton R and Hendy P 'International Comparison of Australia's Taxes', Australian Government April 2006 pages xxii and xxiii.