

Theme 3: Integrity

Diverted Profits Tax and Multinational Anti-Avoidance Law – Practical Insights

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The Australian Government is cracking down on large multinationals to ensure they are paying their fair share of tax in Australia. The diverted profits tax ('DPT') and multinational anti-avoidance rule ('MAAL') are key mechanisms in which the ATO can attack artificial and contrived arrangements entered by significant global entities with their offshore related parties for the principal purpose of obtaining a tax benefit.

The first DPT case is currently before the Federal Court and is expected to provide welcomed precedent on the legal interpretation of the 'principal purpose test' which is relevant to both the DPT and MAAL. In the absence of case law and detailed ATO decisions, uncertainty remains as to when the ATO will seek to apply the DPT or MAAL and how organisations can best engage with the ATO to avoid disputes. Although the ATO has published comprehensive guidance (with illustrative examples of high-risk arrangements) it is yet to be seen whether the ATO is actively identifying and targeting taxpayers with these arrangements.

The MAAL targets arrangements where a large multinational derives income from sales made to Australian customers, where the income is booked offshore and is not otherwise subject to tax in Australia or attributed to a permanent establishment in Australia. Where the MAAL applies, the Commissioner of Taxation has the power to reconstruct the arrangement and make a determination to apply the tax rules as if the taxpayer had been making a supply through an Australian permanent establishment. As the MAAL is an anti-avoidance rule, scheme penalties may also apply.

The DPT has a broader application than the MAAL and applies to schemes entered by large multinationals and their foreign associates for the principal purpose of obtaining a DPT tax benefit. Where the DPT applies, the Commissioner can impose a 40% tax on the amount of the diverted profit, which is payable within 21 days of assessment. Due to the serious and punitive nature of the DPT, there is a thorough ATO compliance process to ensure DPT assessments are appropriately made.

A unique feature of the DPT is that there are no objection rights to a DPT assessment. Instead, there is a 12-month period of review following a DPT assessment, which gives the taxpayer the opportunity to provide further evidence to the Commissioner to support why the DPT should not apply to their arrangement or why the amount of the assessment should be reduced. Importantly, if the taxpayer decides to appeal the DPT assessment to the Federal Court, the evidence presented will be restricted to the information provided to the ATO during the 12-month period of review.

The focus of this paper is on the tax technical aspects, processes and underlying legal concepts that underpin the DPT and MAAL. As the DPT and MAAL are contained within Pt IVA of the *Income Tax Assessment Act 1936* (Cth) it is considered that the key concepts relevant to the general anti-avoidance rule should be applicable to the DPT and MAAL. In addition, this paper considers the options available to taxpayers to obtain advice or certainty in respect of their tax positions and how to manage the risk of DPT and MAAL applying to their arrangements.

The Value of Tax Transparency: Is More Data Better?

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Australia is arguably the global leader in tax transparency. This title was initially earned through Australia's multilateral and unilateral actions in response to the Organisation for Economic Co-operation and Development's (OECD) Base Erosion and Profit Shifting (BEPS) project. For example, Australia endorsed the Multilateral Competent Authority Agreement (MCAA) to increase global co-operation through an automatic exchange of information, passed the Tax Laws Amendment (2013 Measures No. 2) Act 2013 which requires the Australian tax authority to publicly release limited corporate tax data annually, and established the Tax Transparency Code (TTC) for the voluntary public disclosure of corporate tax information.

More recently, Australia's introduction of draft legislation which requires public country-by-country reporting of key tax and operational data for large multinational entities trading in Australia, has been lauded as "groundbreaking" and a "game-changer".

The Australian Government's focus on tax transparency is motivated by three key objectives: (i) to encourage corporations to 'pay their fair share' of tax, (ii) to discourage aggressive corporate tax minimisation, and (iii) to inform the public about corporate tax practices. In sum, these objectives suggest that corporations should be held accountable by the public for their corporate tax behaviours, and that these behaviours are made visible to the public by the disclosure of tax data to stakeholders, those external to the corporation who can affect or be affected by corporate practices, such as governments, suppliers, creditors, investors, customers, employees, and communities.

While extant literature has addressed the limitations of voluntary corporate tax disclosures due to its lack of prescription and flexibility, those disclosures that are mandated, providing tax data directly from the tax authority to the public, are yet to be assessed. Given such data is traditionally treated as confidential, and would be complete, accurate and standardised enabling comparability (i.e., addressing the issues of voluntary corporate tax disclosures), it could provide additional insight to corporate tax behaviour. As such, this paper raises the following research question:

Does mandatory tax transparency provide new data that informs the public, allowing stakeholders to review and assess corporate tax behaviour?

In Australia, the public disclosure of limited corporate tax data is legislated by the Tax Laws Amendment (2013 Measures No. 2) Act 2013 and is released annually by the Australian Tax Office via the Report of Entity Tax Information (ROETI). This paper analyses this data using a two-stage approach. First, we analyse whether the additional tax data provided by the ROETI constitutes new data, and second whether it informs the Australian public.

The assessment of the novelty of the ROETI data was determined by comparing it to data published in corporate financial reports, while the information content of the ROETI data was determined by an event study. Preliminary results suggest that the data published in the ROETI was new, as evidenced by a statistically significant difference between tax (ROETI) and book (financial report) data, but that it fails to inform the Australian public as the event study did not reveal a persistent market response. That is, the new ROETI data did not affect market participants' evaluation of corporations and their tax behaviours. These results taken together, call into question Australia's commitment to tax transparency reform and suggests that more deliberate action or proprietary data (perhaps via country-by-country reporting) is required to assess and influence corporate tax behaviour.

Developing a Tax Avoidance Deterrence Model: Pilot Study Testing the Validity to Assess Intentional Tax Non-Compliance Behaviour

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Taxpayer compliance plays a key role in maintaining the integrity of tax systems around the world and ensuring that Governments raise sufficient tax revenue to cover public goods and services. With the resistance of some taxpayers in meeting their tax obligations, Governments are increasingly cognisant of tax leakage arising from non-compliance behaviour.

Tax compliance is defined as the degree to which a taxpayer complies with the tax legislation, by declaring income, filing a tax return, and paying tax obligations on time. In contrast, non-compliance includes the over or under-reporting tax liabilities, whether intentional or unintentional. This study focuses on *intentional tax non-compliance behaviour*. An extended deterrence model is developed to examine drivers of such behaviour and is pilot tested within the Australian context.

Broadly, non-compliance behaviour can range from multinational corporations utilising transfer pricing mechanisms to small businesses and individuals participating in the shadow economy (previously 'black economy'). In 2018, the International Monetary Fund estimated that the average size of the worldwide shadow economy was 31.9 per cent of GDP. The tax revenues estimated to be lost worldwide is alarming. While shadow economy is not limited to tax issues, this multi-faceted phenomenon has harmful consequences on the tax system such as allowing non-compliant taxpayers to avoid their tax obligations, thus creating a tax gap. The World Bank estimated a total tax gap of USD\$180.8 billion for the top twenty countries with a tax-to-GDP ratio below 15 per cent, accounting for 84 per cent of the world's tax-revenue gap.

Although not limited to intentional tax non-compliance, the Australian Taxation Office in their latest estimated tax gap for the 2019-20 fiscal year, report the tax gap from individuals not in business (individual taxpayers) to be AUD\$9 billion (5.6% net tax gap, above the targeted 4.5%). With the increasing number of countries moving to self-assessment, the onus on the taxpayers to self-lodge and comply with the regulations is important. Thus, this study is focused on understanding the drivers deterring individual taxpayers from non-compliant activities, which in turn drive their compliance behaviour.

Extant research shows there is significant interest in understanding the drivers of tax compliance behaviour and several theories and associated models have therefore been applied and extended to encapsulate motivational postures, including the *Deterrence Theory Model*. With the differences across cultures, tax systems, tax cultures, the type of taxpayers (wage earners to high-income earners), and taxpayers' demographic characteristics (e.g., age, gender, religious background, and level of literacy), it is likely that no single theory can perfectly account for the relationship between taxpayers and the tax system.

Of relevance to this study is the impact of technological advancements on taxpayer lives. These changes may have altered drivers of tax compliance behaviour over time. Consequently, the adoption of electronic tax lodgement ('e-lodgement' or 'e-filing') has led to calls for future research to re-examine the drivers of tax compliance behaviour.

This study responds to such calls through the development of an extended *Deterrence Theory Model* incorporating findings from the *Fear of Victimisation and the Sensitivity of Risk Model* (FVSRM) and applying it to understand taxpayers' propensity to offend (i.e., undertake intentional tax non-compliance behaviour). The model of this study, labelled as the *Tax Avoidance Deterrence Model* (hereafter 'TADM'), incorporates seven factors: (1) *perceived severity* and (2) *perceived certainty of*

the punishment, (3) perceived control, (4) fear of apprehension, (5) tax morale, (6) perceived tax fairness, and (7) propensity to offend.

This study presents findings of a pilot study of the developed TADM and its survey instrument to assess the validity of the developed model in measuring individual taxpayers' intentional tax non-compliance behaviour. A novel vignette-based instrument was developed for the Australian tax lodgement system to (1) measure the drivers of taxpayers' compliance behaviour, and (2) the relationship of specific technological infrastructure (such as e-filing) with these deterrent drivers. The TADM measurement was validated through a content validity process. This process involved both qualitative and quantitative tests. The domain constructs are first specified, and then the sample items and questionnaire scaling are generated. We also minimise possible survey errors by following methods of coping.

For the qualitative validation process, we pre-tested the instrument with twelve Australian taxpayers by inviting them to complete the survey. This was followed by a pilot test to account for the participants' qualitative comments after completing the survey. Participants were asked to comment on (1) the representativeness of the measurement, (2) the clarity of the questions, (3) the suitability of the scaling, and (4) the suitability of the sample items. The instrument was then amended to incorporate the recommendations of the participants on (1) the representativeness of the measurement, and (2) the clarity of the questions.

During the quantitative validation process, the instrument was further validated by accounting for experts' views (interrater agreement). A total of twenty experts including, academics and tax practitioners, were provided with the amended instruments along with the recommendations of the pilot test participants to assess the suitability of the instrument to measure individual taxpayers' compliance behaviour. Exploratory factor analysis resulted in final refinements for sample items within the questionnaire.

This study contributes to the existing literature by developing a new extended deterrence model capable of (1) measuring the relationship between offenders' cognitive assessment and their emotional fear and (2) accounting for the possible relationship between the technological advancements brought to the taxation system and the drivers of tax compliance behaviour. To our knowledge, our TADM is the first model to extend the deterrence model by incorporating findings from the FVSRM to understand taxpayers' propensity to offend. Future studies are invited to test the TADM using our measurement.