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Taking on Tax Avoidance

A Plan to End Tax Avoidance in the Extractive Resources Sector

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Contents

Foreword

For most Australians, paying their fair share of taxes is an accepted responsibility.

Every worker who earns over $18,000 per year contributes income tax that pays for the services all Australians rely upon – for healthcare, for defense and security, for education, for the roads we drive on and the buses we catch to work.

Even those who are no longer working or who are unable to work contribute through the GST – an inescapable tax that falls upon all those Australians who participate in our economy.

Individuals might at times begrudge these heady responsibilities that fall on their shoulders. But they understand its importance in maintaining the Australian way. Only rarely do individual workers engage in complicated schemes to minimize their tax. And seldom are they low or middle income earners.

A vast majority of small, medium and large enterprises in Australia also do their bit – keeping on top of their affairs and paying their fair share of tax.

But while most Australian citizens and businesses are upholding their end of the bargain, too often they are being let down by a select group of large, multinational companies who are abrogating their responsibilities as corporate tax payers in Australia.

Corporate tax avoidance is increasingly common in Australia, particularly by major multinationals, many of which are in the extractive resources sector.

Unlike individuals and small businesses, major multinationals have the resources to invest in complicated schemes aimed at minimizing their tax liability within Australia.

The result is that many companies that are extracting finite Australian resources, and selling them for significant profits, are paying very little or in some cases zero tax. This unfair arrangement shifts more of the tax burden on Australian workers and compliant businesses.

Some examples of tax avoidance are particularly egregious: Exxon, for example, despite generating tens of billions in income from Australian resources and sales, last paid corporate income tax in 2013 and does not anticipate paying any corporate income tax until 2021. While Exxon is entitled to recoup investments, an 8-year tax holiday is unacceptable.

Multinational investment in Australia is a vital component of Australia's trading economy. But it is unsustainable to have tax laws that are able to be exploited by those multinationals profiting so extensively off Australian resources.

Australia's anti-tax avoidance regime needs further enhancement and further enforcement. This report plots a path forward, offering a 10 point plan that aims to strengthen Australia's existing tax avoidance regime to ensure no multinational can profit of Australian resources without paying their fair share of tax.

Executive Summary

This report tables a 10 point plan for strengthening Australia's anti-tax avoidance regime.

Tax avoidance by major multinationals is costing Australians billions of dollars every year. But while large multinationals may have become increasingly savvy at minimizing their tax burden within Australia through complicated processes, there are real steps that can be taken to make it more challenging for them to do so.

The report first argues in favour of adopting public Country-by-Country Reporting, which would require multinationals to disclose all subsidiaries and the jurisdictions they operate in, as well as information about the taxes they have paid – a policy that has been discussed but, so far, not implemented anywhere in the world.

Focusing further on transparency initiatives, this report outlines how a mandatory disclosure policy is needed to bring Australian into line with other countries. A mandatory disclosure for extractive companies would see extractive companies required to publish their payments to all levels of government. Additionally, the introduction of an Extractive Industries Transparency Initiatives would further boost transparency in the sector, and bring Australia up to speed with other countries in the region, such as Indonesia, Papua New Guinea, and the Philippines.

This report then recommends further reform to Australia's transfer pricing regulations and to eliminate reduced disclosure requirements and special purpose options for annual financial statements filed with ASIC. Major extractive companies use 'reduced disclosure requirements', or 'special purpose' options which have incomplete information and should be eliminated.

A mandatory tax transparency code is then explored. The Treasury should be tasked with analysing global best practice and develop a model framework for Australia. The Petroleum Resources Rent Tax (PRRT), also requires further reforms, as it still generates minimal revenue. While the incumbent government, two years after initiating a review, has recently introduced some minor reforms to the PRRT, more work is needed to ensure the framework begins delivering more revenue. The major issue of the pricing the gas for PRRT has been kicked further down the road for a future government to decide. Even after recent reforms, major new offshore LNG projects are still unlikely to ever pay any PRRT.

The report concludes by offering further transparency and justice initiatives, such as ensuring executives are held to account for any misleading statements to parliament, and that the Australian Taxation Office (ATO) be granted the authority to disclose major tax disputes with multinationals. Currently, the strict rules around ATO disclosure means that it is effectively prohibited from making costly corporate tax disputes public. This leaves the public in the dark about major cases of tax avoidance with significant revenue implications.

Tax avoidance by multinationals is a major issue in Australia. It undermines Australia’s tax system, places increased responsiblities on individual tax payers and small businesses, and has for too long been treated with too high a degree of tolerance. As this report demonstrates, there are practical ways in which the Australian government can tackle tax avoidance, and ensure all businesses in Australia – big and small – are operating on an even playing field.

A Reform Agenda for the Taxation of Multinational Oil Giants

The Australian Government has implemented changes to tax policy that have impacted future tax payments of Exxon and other multinational oil companies[i]; however, there are several other tax policy proposals that should be enacted to ensure integrity of the system and fair payments to the Australian people for the exploitation of finite natural resources and the domestic marketing of petroleum products.

Greater public awareness and political will are needed to make these essential changes as soon as possible. This report explores several existing policy proposals that should be enhanced and embraced, as well as some new policies that should be considered. It should also be noted that there are obvious connections and inter-relationships to the domestic energy market where there have also been significant policy failures with major consequences for Australian industry and consumers.

Priority 1: Public Country by Country Reporting (CbCR)

The Federal Opposition has included implementation of public CbCR as part of a broader set of tax policies.[ii] While Australia[iii] and other countries[iv] have implemented CbCR, it is only seen by the tax office and not publicly available. CbCR requires all multinational companies to disclose all subsidiaries in all jurisdictions along with basic information about economic activity and taxes paid. The ATO has publicly stated that this information has been very useful for them.[v] While other countries and the EU have discussed public CbCR[vi] it has not yet been implemented anywhere[vii]. Allowing the public to have access to this data would help to hold Exxon and other multinationals accountable in Australia and globally.

A version of public CbCR was included as a recommendation in the final report (30 May) Senate Inquiry into Corporate Tax Avoidance[viii] but opposed by Government Senators.

A study based on the CbCR that analyses the misalignment between economic activities and taxes paid should be undertaken by appropriate federal authorities. This would be a useful exercise, but importantly would make it easier to explain the impact, purpose and potential of public CbCR. The impact on the corporate tax debate in Australia could be even more significant than the introduction of the corporate tax transparency data which is already legislated.

A recent study on the implementation of public CbCR reporting on banks in the EU has shown a meaningful impact on curbing corporate tax avoidance.[ix] The OECD BEPS (Base Erosion & Profit Shifting) Action 13 report provides a template that can easily be adopted for a public CbCR.[x] Several multinational firms, including Unilever and Vodafone Group plc, already voluntarily publish a version of CbCR and other companies are also likely to begin voluntary reporting[xi].

Priority 2: Mandatory Disclosure Policy for Extractives

The Federal Opposition has adopted a mandatory disclosure policy for extractive companies which would bring Australia in line with other countries, including the UK, Canada and the EU which already have these policies in place[xii]. Mandatory Disclosure is similar to public CbCR except it provides even more detail on a range of tax payments, but only applies to large extractive companies. Mandatory Disclosure requires public disclosure of all payments to all levels of government on a project by project basis. This would include payments such as licenses and fees, royalties, income tax, and others depending on the project. Implementation of Mandatory Disclosure for Extractives in both the UK and Canada provide existing models which Australia can easily follow.

It is worth noting that Australia's two largest extractive companies, BHP and Rio, are already in compliance with mandatory disclosure policies because they are dual listed in the UK. Therefore, those companies would be likely to support mandatory disclosure in Australia. They would also have limited opposition to public CbCR since they already disclose global information on tax payments by country. It is also worth noting that Glencore's mandatory disclosure report in the UK provides far more information on tax payments in Australia than any data publicly available from Australia.[xiii] The UK mandatory disclosure filings of Glencore show that the Swiss-based company paid very little tax in Australia but paid more tax in Australia than in any other country.

Priority 3: Implement the Extractive Industries Transparency Initiative (EITI)

The EITI is a global initiative designed to increase transparency and reduce corruption in the resource sector. The EITI was launched in 2003. Fifty-one countries have implemented the EITI, but Australia is not among them. Despite being a major global funder of EITI and pledging to join in 2016 very little domestic progress has been made.[xiv] As a necessary step, the Australian Government established a Multi-Stakeholder Group representing civil society, government and industry, but more than two years on has failed to even apply for EITI candidacy from the International Secretariat.

Several other countries in the region, including Indonesia, the Philippines, PNG, as well as other jurisdictions are EITI compliant, but Australia is not.[xv] Ironically, the Australian government is a major funder of the global EITI initiative and provides development aid to countries for EITI implementation that are much further along in the process than Australia. Future Australian governments can provide leadership, and immediately apply for EITI candidacy and aim for certification by 2021, or as soon as possible. The EITI is another means of providing public transparency on payments to government and resource extraction. At the moment, there is more public information on resource extraction in Indonesia, the Philippines and many other countries than there is in Australia.

It is worth noting that Exxon and Chevron have been on the global EITI board, but civil society organisations in the US are demanding that they be removed from the global board as they have undermined the EITI process in the US under the Trump administration by refusing to provide information to the EITI on tax payments in the US[xvi].

Priority 4: Reform of transfer pricing regulations

Exxon has faced additional tax assessments by the ATO for interest deductions for offshore related party loans that have been disallowed under new ATO practical compliance guidelines. These guidelines were a direct result of the ATO's landmark Federal Court case against Chevron[xvii]. However, the Government should consider the further strengthening of transfer pricing regulations beyond offshore related party debt, including updated transfer pricing policies and guidelines and annual certification with director and auditor liability in the case of an identified breach of new guidelines.

The Federal Court ruling in the Chevron case explicitly redefined the current meaning of "arm's length" as used in the global OECD transfer pricing guidelines. The Federal Court rejected the long-standing legal principle that allowed transactions between subsidiaries of the same multinational to be at "arm's length" on the basis that they were between separate legal entities. A reinvigorated transfer pricing policy could require annual certification or review of compliance on all forms of transfer pricing by multinationals. CFOs, company directors and auditors could be held liable for any breaches of renewed transfer pricing guidelines. The Government should commit to examine the experience of similar policies in countries such as Canada and Mexico, and propose new transfer guidelines that match international best practice.

The Federal Opposition does have an existing policy to limit interest deductions to a company's global gearing ratio. This would help tighten the rules.

The final report of the Senate Inquiry into Corporate Tax Avoidance recommended that "the Government undertake an independent review into the detriment to Australian tax revenue that arises from the current transfer pricing regime, and explore options to modify transfer pricing rules, or other tax laws, to ensure multinational enterprises make the appropriate contribution to Australian tax revenue."[xviii]

These changes to transfer pricing rules could collect income tax revenues from Exxon's significant downstream fuel business in Australia. Currently, the high cost of buying oil and other imports or services from related parties in Singapore and other markets is very likely to transfer profits from Exxon's downstream business out of Australia. This is clearly the case in New Zealand, where there is no upstream business, and very likely in other markets with significant downstream operations.[xix]

Priority 5: Eliminate reduced disclosure requirement and special purpose options for annual financial statements filed with ASIC

Exxon and most other multinationals currently use reduced disclosure requirements or special purpose options to file annual financial statements with ASIC for private subsidiaries incorporated in Australia. These reduce disclosure requirement filings have far less information than required by the full set of Australian accounting standards. The Government should immediately eliminate reduced disclosure requirements as an option for Australian subsidiaries of multinationals with Australian revenue of over $500 million. After implementation, companies could be given a 6-month grace period after which any future annual reports would not be able to use reduced disclosure or special purpose options. The increased cost of compliance would be minimal.

The Australian Accounting Standards Board has initiated a consultation process on related reforms to maintain compliance with international reporting standards. This process is likely to recommend that reduced disclosure requirements be eliminated for large companies. The final report of the Senate Inquiry into Corporate Tax Avoidance unanimously recommended that "the Government require all companies, trusts and other financial entities with income above a certain amount to lodge general purpose financial statements with" ASIC[xx].

Priority 6: Mandatory Tax Transparency Code

The Senate Inquiry, mentioned above, recommended that "the existing voluntary tax transparency code be converted, as soon as practicable, to a mandatory code for all large and medium corporations operating in Australia, including subsidiaries of multinational corporations."[xxi] Exxon has tried to hide behind the report that it submitted as part of the voluntary tax transparency code. The tax transparency codes submitted by Exxon and Glencore offer the best examples of why a voluntary code is useless and highly misleading.[xxii] It is also worth noting that Glencore is currently suing the ATO over leaked documents that explain Glencore's aggressive tax practices and that Exxon has spent over $10 million in fighting the ATO in courts.[xxiii]

The Government should commit to creating a mandatory tax transparency code and include a link to each company's tax transparency report as part of the current annual disclosure by the ATO of the existing corporate tax transparency data. The ATO data should also include the value of any tax losses carried forward in the corporate tax transparency data. These changes would likely be acceptable to most businesses, make the data more useful and create a model for corporate tax transparency that other countries should be encouraged to implement.

The Government should task the Australian Treasury with analysing global best practices in mandatory tax transparency codes and initiate a consultation period to develop explicit guidelines and requirements for mandatory tax transparency reports by companies. Implementation of a mandatory tax transparency code and improvements to the corporate tax transparency data should be concluded within a 12-month timeframe.

Priority 7: Further Reforms of the Petroleum Resource Rent Tax (PRRT)

The PRRT is currently failing to generate revenue from Australia's booming offshore LNG exports[xxiv]. As a 25% owner of the massive Chevron operated Gorgon project, Exxon benefits from the failure of the PRRT. Under the current PRRT system, Exxon and other companies are extracting and exporting Australia's offshore gas and have been getting it for free for decades. It is also worth noting that the PRRT payments that Exxon has made on its 50% interest in Bass Strait are significantly lower than BHP's, which owns the other 50%.[xxv] The vast majority of all PRRT payments come from Bass Strait.

Significant, but reasonable, reforms to the PRRT are possible which would not impact the long-term investment returns of the project, keep Australia globally competitive and guarantee that Australia is getting a minimal return from the exploitation of our finite natural resources. This has been demonstrated by recent Federal Government policy aimed at delivering more sustainable PRRT revenue in the future[xxvi] – though more can be done.

With the exception of the gas reservation policy in Western Australia, all of the new offshore gas resources are exported while Australia's east coast gas market faces shortages and spikes in prices. While Australia is on the verge of being the world's largest exporter of LNG, there is serious discussion of LNG import terminals being built to supply the east coast market.

The 2018 NSW ALP Conference approved significant and meaningful reforms to the PRRT which have been referred to ALP National Conference. Theses reform proposals have been supported by the Greens and a wide range of smaller political parties across the political spectrum. The final report of the aforementioned Senate Inquiry into Corporate Tax Avoidance, however, failed to make meaningful recommendations on PRRT reforms.

The one possible exception is the recommendation "that the gas transfer pricing method… be reformed to make it simpler and more transparent so as to ensure that it delivers a fair return to the community." Unfortunately, the Government's recent proposed changes to the PRRT have not addressed the gas transfer pricing method, but "asked Treasury to lead a review of the gas transfer pricing arrangements" and "report back within 12 to 18 months."[xxvii]

The Government's Callaghan Review into the PRRT, which was first announced in November 2016, estimated that if the "net-back method" – a method for calculating the market value of gas by detracting processing, manufacturing, transport and other costs from the raw price of the commodity - were used as the default method to value gas, PRRT revenue would increase by $89 billion between 2023 and 2050 and result in bring forward the timing and volume of future PRRT payments.[xxviii] Using the net-back method as the default method for pricing gas on all integrated LNG projects was also discussed as an option in the Australian Treasury's Consultation Paper, "Options to address the design issues identified in the Petroleum Resource Rent Tax Review", from June 2017.[xxix] The key problems in the current gas transfer pricing mechanism are a lack of transparency and the ability to use transfer pricing in an integrated project to artificially lower PRRT payments.[xxx]

The final report of the Senate Committee also recommended that "the Government overhaul uplift rates for future Petroleum Resource Rent Tax eligible projects, so as to make them less generous." This has now been done – in part – with the Government's proposed PRRT reforms which are estimated to raise $6 billion in additional revenue over the decade.[xxxi]

Applying a 10% royalty to all offshore gas projects that are currently only subject to the PRRT – a proposal that was the subject of a previous McKell Institute report - is estimated to produce $2.8 billion in revenue per year[xxxii]. This compares to Chevron and Exxon both admitting in Senate testimony that they did not expect to pay any PRRT -or any other royalty- on the Gorgon and Wheatstone projects until the mid-2030s at the earliest. It is possible, as outlined in some scenarios in the Callaghan Review, that they would never pay any PRRT on these projects.

The 10% royalty would level the playing field for all oil and gas projects, most of which already pay a 10% royalty, and could have a positive impact on the GST distribution formula. Current royalty payments from the North West Shelf project are disappearing rapidly as new offshore fields are not covered by the existing NWS royalty scheme and only by the ineffective PRRT regime.[xxxiii] This decline in royalties is causing more of the GST revenues to be sent to Western Australia and decreasing GST distributions to other states. A proposed 10% royalty, on top of the reformed PRRT system, would go a long way to addressing national shortfalls in GST revenue and distribution.

Some in the industry have complained of sovereign risk and retrospectivity, arguing that any changes to current taxation regimes could undermine investment in current and future projects. These issues, however, are overblown and being used as a scare tactic to minimise changes to the current PRRT system, which sees Australia collect considerably less revenue as a percentage of oil and gas production than other major producers. Several recent studies by academics have shown that Australia's fiscal regime for oil and gas is exceedingly generous by global standards.[xxxiv] Even with the proposed 10% royalty and other PRRT reforms, Australia's fiscal regime would remain among the world's most competitive. The current PRRT system was designed decades ago for oil exploration and not the current surge in offshore gas production and desperately needs to be modernised. The current system was designed to incentivise the development of marginal oil projects which in today's environment no longer makes sense.

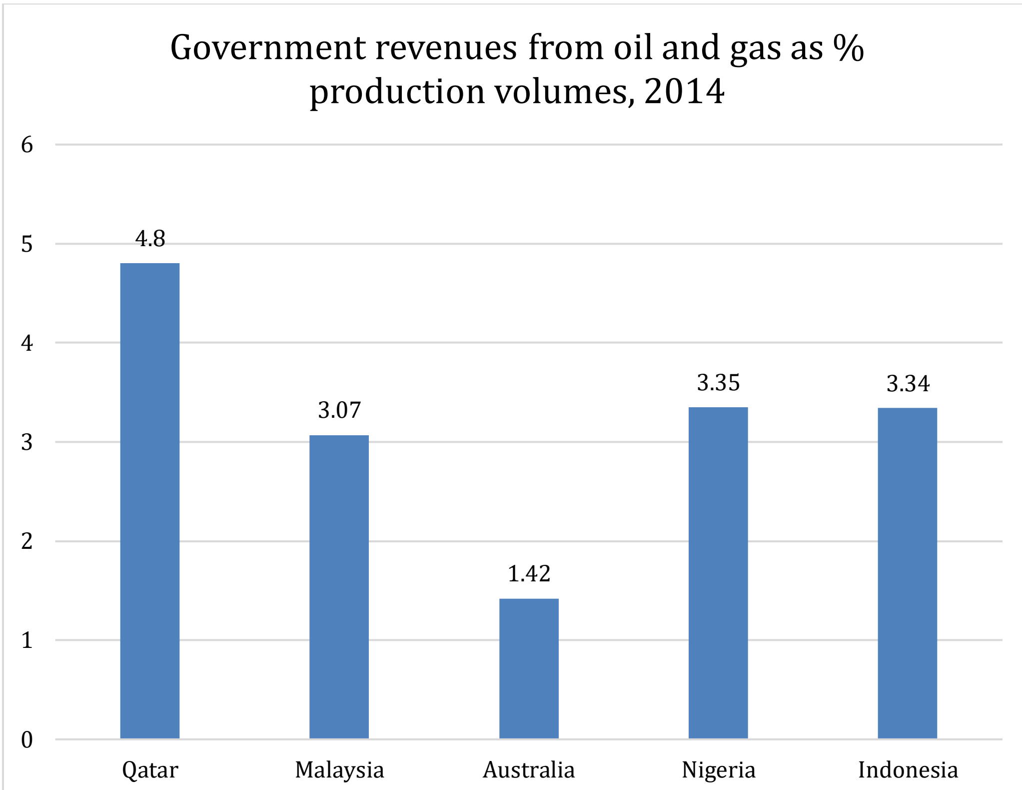

Figure 1.1: Government revenues from oil and gas as a % of production volume, 2014. Source: International Transport Workers' Federation.[xxxv]

Priority 8: Exxon Executives should be held accountable for statements to Parliament and tax avoidance in PNG operations owned through Australia

In 2015, Exxon was specifically asked to provide information on relationships and transactions with related parties offshore. At that time, Exxon failed to disclose the basic fact that company was owned through a shell company in the Netherlands, then through the Bahamas and then through two separate Delaware entities. After the final hearing of the inquiry, in which the focus was entirely on Exxon, the company was asked to provide the full details of the ownership structure related to Australia. While Exxon's response to questions on notice did confirm the Dutch, Bahamas and Delaware entities which own the Australian business, the company failed to disclose the separate ownership of the company's upstream business in Papua New Guinea (PNG).

Exxon's upstream investment and LNG production and export from PNG is of major global significance for the company. While revenues from the PNG LNG project have been huge, payments to governments and traditional landowners have been minimal and there has been civil unrest as a result. There is significant evidence of aggressive tax avoidance by Exxon and its partners, including two Australian companies, in PNG.[xxxvi] LNG is exported to a number of large Asian customers through sales contracts through the Bahamas. The Bahamas entity has also lent money to the PNG LNG project. While the ATO has cracked down on the use of Singapore as a marketing hub for resource companies in Australia, using the Bahamas as a marketing hub to sell to Asian customers takes this practice to a different level.

Given that the ownership of this project runs through an Australian incorporated entity, that is also a taxpayer in Australia, the Government should demand that the ATO assist the PNG Government in investigating Exxon's corporate structures in PNG and make sure that appropriate taxes and payments are made to both Governments and to traditional landowners in PNG. It is possible that the Australian ownership may help shield Exxon from the US Foreign Corrupt Practices Act (FCPA), which imposes significant penalties for bribery and corruption. The FCPA is significantly stronger and more easily enforced than any comparable laws in Australia.

Priority 9: ATO Disclosure of Significant Disputes or Settlements

Exxon has been involved in several Federal Court challenges against the ATO to challenge assessments of both PRRT and income tax and to prevent the disclosure of company information. In Exxon's recent response to questions on notice they estimated having spent $10 million in legal costs fighting the ATO. The ability of Exxon and other multinational companies to constantly challenge the ATO -and tie up limited Government resources in expensive legal costs- has an impact on the broader integrity of the tax system.

The ATO cannot discuss information about any individual corporate taxpayer. The Government should consider amending laws to allow the ATO to publicly reveal information concerning corporate tax disputes over a certain threshold. If a tax dispute with a major corporation concerns hundreds of millions of dollars, the matter should be considered of national significance and the public's right to know should take precedent over a company's right to privacy. Increased disclosure of major corporate tax disputes would act as a deterrent, make it clearer to other companies what tax practices will not be tolerated, and increase transparency.

Similarly, settlements that the ATO reaches with corporate taxpayers that are over a certain threshold in value or set important precedents should also be made public.

Priority 10: Requiring Annual Estimates of Known Reserves

The Government must require companies to disclose annual estimates of known reserves that they control. It is impossible to make public policy decisions without having access to estimates of resources that are owned by the Australian Government. Australia is unique in not collecting and publishing information on the nation's resources and their exploitation. One key flaw revealed in the Callaghan review was that the government does not actually possess reliable data on known reserves and/or the ability to predict future production levels. Data was purchased from industry consultant Wood Mackenzie and companies were allowed to alter the data to suggest higher future PRRT payments.

The vast majority - 87% - of new offshore gas production capacity, which is only subject to PRRT and no other form of royalty payments, is owned by foreign multinationals. Woodside is the only Australian company with an interest in new offshore gas resources. The largest multinationals exploiting Australia's world leading new offshore gas resources – Chevron, Exxon and Shell – all have a track record in Australia and globally of aggressive tax avoidance. It is also worth noting that there is significant ownership by several foreign state-controlled enterprises that have made investments in Australia specifically to secure their own nation's energy security.

There are clearly major revenue implications and strong national interests at stake and modest and reasonable reforms to increase transparency on taxation and resource reserves across Australia's oil and gas sector are desperately needed.

Conclusion

Tax avoidance in the extractive resource sector is a global problem Australia is not immune to. As a continent-nation richly endowed in resources, Australians should enjoy living in a country the capitalizes as well as it can on the economic benefits associated with its natural bounty.

But current regulations do not go far enough in ensuring multinational companies within Australia – particularly those major companies within the extractive resources sector – pay their fair share of tax.

Unlike individuals and small businesses, major multinationals have the resources to exploit loopholes and conceive complicated tax avoidance strategies that take advantage of their footprints in multiple jurisdictions. The result is that, while many companies profit greatly from the extraction and selling of Australia's finite natural resources, they often do so without paying any tax on their income.

This report has put forward ten recommendations that would strengthen Australia's anti tax avoidance regime with a particular focus on transparency. By making the dealings of the industry more transparent, companies that do the wrong thing – and governments that fail to enact strong and vital regulations – can be held to account.

It is time the Federal Government began to treat the issue of tax avoidance in the extractive resources sector with the urgency it deserves. Doing so will help improve the budget bottom line, and help ensure the extractive resources sector benefits all Australians, not just a select few.

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