Parliamentary
Budget Office

Policy costing

Ending Corporate Tax Avoidance		
Person/party requesting the costing:	Mr Adam Bandt MP, Australian Greens	
Date costing completed:	4 November 2021	
Expiry date of the costing:	Release of the next economic and fiscal outlook report.	
Status at time of request:	Submitted outside the caretaker period	
	☒ Confidential	☐ Not confidential

Summary of proposal:

The proposal consists of six components.

Component 1: Deny royalty tax deductions to Significant Global Entities (SGEs) for related party transactions.

Deny SGEs a tax deduction for royalties for the use of, or right to use, intellectual property within Australia, when either:

- the royalties are paid to a related party
- the party to which they are paid is in a jurisdiction that provides preferential tax treatment for intellectual property royalties.

Component 2: Change thin capitalisation rules.

- Remove the 'safe harbour' and 'arm's length' debt tests, leaving only the 'worldwide gearing' debt test.

Component 3: Improve public access to company reporting.

- Require currently 'grandfathered' large proprietary companies with assets greater than \$25 million and total income greater than \$50 million to lodge financial reports.
- Abolish fees for the provision of company information and provide all company information through the Australian Securities and Investments Commission's (ASIC) online public registers.

Component 4: Denial of bad debt write-offs.

- Deny creditors a tax deduction for a bad debt written-off, where the debtor is a related party.

Component 5: Implement a withholding tax on fixed trust cash distributions to non-residents

- Apply a minimum final withholding tax of 30% on fixed trust cash distributions to non-residents. Non-residents would not be able to claim a refund of this withholding in Australia. Distributions to non-residents paid out of managed investment trusts or collective investment vehicles would not be subject to the withholding tax.

Component 6: Increase in promoter penalties.

- Double the promoter penalty associated with the promotion of tax avoidance schemes.
- Under this proposal the penalty units associated with violating the promoter laws would be:
  - 10,000 penalty units for individuals
  - 50,000 penalty units for companies.

The proposal would take effect from 1 July 2022.

Costing overview

The proposal would be expected to increase both the fiscal and underlying cash balances by around $926 million over the 2021-22 Budget forward estimates period. This impact reflects an increase in revenue of $1,137.5 million and an increase in expenses of $211.1 million over the 2021-22 Budget forward estimates period.

The proposal would be expected to have financial implications that extend beyond the 2021-22 Budget forward estimates period. Financial implications (including separate PDI tables) over the period to 2031-32 are provided at Attachment A.

There is a significant level of uncertainty associated with each component of this proposal and the uncertainty in particular components drives significant uncertainty in the overall cost.

Uncertainty of the estimate for Component 2 arises from the interaction with the 2018-19 Budget measure, *Tax integrity - thin capitalisation-valuation of assets and treatment of consolidated entities.* More specifically, the extent to which the 2018-19 Budget measure will affect asset values and thereby the ability of entities to make debt interest deductions under thin capitalisation rules.

- The Parliamentary Budget Office (PBO) has estimated this interaction effect as part of Component 2, assuming that the 2018-19 Budget tax integrity measure will have a positive impact on company tax revenues.

Uncertainties arise from behavioural responses to Component 1 and 2 as it is difficult to predict how and the extent to which companies will restructure their operations to minimise their income tax liabilities.

- To account for these behavioural responses, the PBO has made several high-level adjustments to the tax base, although it should be noted that the actual magnitude of these responses remains highly uncertain in addition to their distribution across business entities.

Table 1: Financial implications ($m)[(a)]

	2021–22	2022–23	2023–24	2024–25	**Total to 2024–25**
Fiscal balance	-	-69.0	575.9	419.5	**926.4**
Underlying cash balance	-	-69.0	575.9	419.5	**926.4**

(a) A positive number represents an increase in the relevant budget balance; a negative number represents a decrease.
(b) PDI impacts are not included in the totals
- Indicates nil.

Key assumptions

The Parliamentary Budget Office has made the following assumptions in costing this proposal.

Component 1

- Royalty deductions would grow in line with the gross operating surplus (GOS) of corporate entities and gross mixed income (GMI) growth.
- Affected companies would restructure their finances to minimise paying additional tax on royalty payments.

Component 2

- Debt interest deductions subject to thin capitalisation rules would increase by 5% each year.
- In the year 2022-23, 10% of affected companies would find alternate financing strategies in response to the proposal, rising by an additional 2% of affected companies each subsequent year.

Component 3

Removal of AISC 'grandfathering' provisions for large proprietary companies

- Grandfathering provisions would apply to 17% of large proprietary corporations.
- Departmental costs per financial document lodged would be included in existing ASIC fees and would not be passed on to affected companies under the proposal.
- Manual intervention would be required for 10% of financial report lodgements.

Removal of ASIC search fees

- Search fees would grow in line with CPI in the absence of the proposal.
- ASIC would employ an additional nine full-time equivalent staff to administer this component.
  - These figures are based on the current staffing profiles of the business area responsible for registry services as reported in ASIC's 2019-20 annual report.

Component 4

- The amount of total bad debt deductions would not change materially over the medium term as a result of behavioural responses to the component.
- The proportion of deductions related to bad debts from related parties would not materially change over time.

Component 5

- Fixed trust distributions paid to non-residents in the 2021-22 Budget forward estimates period would grow in line with nominal gross domestic product.

Component 6

- There would be a behavioural response associated with this proposal. The value of fines levied would decrease by 0.5% after the increase in penalties.

Methodology

Component 1

Revenue from the denial of royalty deductions for SGEs was estimated by calculating the increase in taxable income from the royalty deductions denied. This was done using data on historical deductions made by SGEs under the existing rules. The proportion of additional tax revenue was then calculated. The figures were then projected into the medium term using the growth in gross operating surplus in corporations and GMI.

Information on historical royalty deductions, taxable income and tax payable for SGEs was provided by the Australian Taxation Office (ATO). Medium term projections for the GOS of corporate entities and GMI was provided by the Department of the Treasury.

Component 2

Revenue from the removal of the 'safe harbour' and 'arm's length' thin capitalisation tests was estimated by calculating the level of allowable debt under the remaining 'worldwide gearing' test and using this to determine the amount of additional debt interest deductions that would be denied under the proposal. The figures were then projected into the medium-term using Treasury parameters before the additional company tax revenue was calculated.

The interaction effect between Component 2 and the 2018-19 Budget Measure, *Tax integrity – thin capitalisation – valuation of assets and treatment of consolidated* entities was then calculated and added to the total.

Component 3

Removal of ASIC 'grandfathering' provisions for large proprietary companies

Departmental costs for the removal of grandfathering provisions were estimated using the approximate cost per document lodgement and multiplying this by the number of affected businesses. The total cost is then multiplied by the percentage of lodgements requiring manual intervention. These estimates were then projected into the medium term using the wage cost index.

Removal of ASIC search fees

Administered expenses from the removal of search fees were estimated by taking the historical proportion of search fee revenue in combined search fee and fine revenue and multiplying this by the combined revenue estimated over the Budget forward estimates period. This figure was projected into the medium-term using CPI. Associated departmental costs were estimated based on our assessment of the additional staff required by ASIC and existing staffing profiles. These costs were projected into the medium term using the wage cost index.

Information on the number of large proprietary companies under 'grandfathering' provisions was derived from the Australian Bureau of Statistics' (ABS) publication Counts of Australian Businesses, Entries and Exits and ATO company income tax returns.

Component 4

The ATO's *2018-19 Taxation Statistics* contains data on the quantum of bad debts held by companies. The level of bad debts was averaged from 2012-13 to 2018-19. The companies that are already covered by the multinational anti-avoidance law are removed, the level of bad debt was multiplied by the percentage attributable to related party debt and then the proportion of bad debt to be included in the lender's assessable income. The additional taxable income was multiplied by the corporate tax rate to give the cost of this proposal.

Component 5

The ATO provided a dataset of distributions by trusts to non-residents by payment type for the 2019-20 financial year.

The amount of additional withholding tax was calculated based on the ATO file and the above assumptions.

Estimated additional annual withholding tax revenue was then calculated based on 30 per cent of gross distributions for the 2019-20 financial year. The additional revenue was projected over the 2021-22 Budget forward estimates period taking into account economic growth and the timing of tax collections.

Component 6

The total fine revenue was estimated by averaging reported fine revenue over 2015-16 to 2017-18. The baseline fine revenues were grown out using the medium-term estimates for CPI. The value of fines levied were scaled by the change in policy after accounting for the behavioural response and compared to the baseline fine revenue to give the cost of the component.

Financial implications for all components were rounded consistent with the PBO's rounding rules as outlined on the PBO Costings and budget information webpage[1].

Data sources

Australian Bureau of Statistics, 2021. *Counts of Australian Businesses, including entries and exits, July 2016 – June 2021.* Australian Bureau of Statistics, Canberra, Commonwealth of Australia.

Australian Securities and Investments Commission, 2019. *2019-20 Annual report.* Available at: <https://asic.gov.au/about-asic/corporate-publications/asic-annual-reports/> [Accessed 28 October 2021].

Australian Securities and Investments Commission, 2021. *Fees for commonly lodged documents.* Available at: < https://asic.gov.au/for-business/payments-fees-and-invoices/asic-fees/fees-for-commonly-lodged-documents/> [Accessed 28 October 2021].

The Australian Taxation Office provided a complete dataset of non-resident royalty payments by significant global entities for the 2016-17 and 2017-18 financial years.

The Australian Taxation Office provided de-identified information from the International Dealings Schedule for the period 2016-17 through to 2019-20.

The Australian Taxation Office provided a dataset of non-resident trust fund payments and withholdings for the 2018-19 financial year.

The Australian Taxation Office, 2020. *Taxation Statistics 2018-19*, Canberra: Commonwealth of Australia.

Commonwealth of Australia, 2019. *2019-20 Budget*. Canberra, Commonwealth of Australia.

Commonwealth of Australia, 2018. *2018-19 Budget*, Canberra: Commonwealth of Australia.

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[1] https://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Budget_Office/Costings_and_budget_information

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Company level financial data were extracted from financial statements provided to the Australian Securities Exchange and the New York Stock Exchange.

The Australian Taxation Office provided a de-identified sample of company tax returns for the 2018-19 financial year.

The Department of the Treasury provided forecasts of economic parameters as at the 2021-22 Budget.

Attachment A – Ending corporate tax avoidance – financial implications

Table A1: Ending Corporate Tax Avoidance – Ending corporate tax avoidance – Fiscal and underlying cash balance ($m)[(a)]

	2021–22	2022–23	2023–24	2024–25	2025–26	2026–27	2027–28	2028–29	2029–30	2030–31	2031–32	Total to 2024–25	Total to 2031–32
Revenue													
Component 1: Deny significant global entities a tax deduction for royalties for the use of, or right to use, intellectual property within Australia	-	-	*348.0*	*196.0*	*206.0*	*217.0*	*229.0*	*242.0*	*255.0*	*269.0*	*284.0*	***544.0***	***2,246.0***
Component 2: Including only worldwide gearing ratio test for thin capitalisation	-	-	*245.0*	*240.0*	*252.0*	*261.0*	*260.0*	*272.0*	*284.0*	*296.0*	*319.0*	***485.0***	***2,429.0***
Component 4: Deny creditors a tax deduction for a bad debt written-off	-	-	*10.0*	*10.0*	*10.0*	*10.0*	*10.0*	*10.0*	*10.0*	*10.0*	*10.0*	***20.0***	***90.0***
Component 5: Minimum final withholding tax of 30 per cent on fixed trust cash distributions to non-residents	-	-	*43.2*	*45.3*	*47.6*	*49.8*	*52.2*	*55.0*	*58.0*	*61.2*	*64.5*	***88.5***	***476.8***
Component 6: Increase in promoter penalty laws	-	..	..	..	..	..	..	..	..	*0.1*	*0.1*	**..**	***0.2***
Total – revenue	**-**	**-**	***646.2***	***491.3***	***515.6***	***537.8***	***551.2***	***579.0***	***607.0***	***636.3***	***677.6***	***1,137.5***	***5,242.0***
Expenses													
Administered													
Component 3: Improve public access to company reporting	-	*-67.0*	*-68.6*	*-70.3*	*-72.0*	*-73.7*	*-75.6*	*-77.4*	*-79.4*	*-81.4*	*-83.4*	***-205.9***	***-748.8***
Total – administered	**-**	***-67.0***	***-68.6***	***-70.3***	***-72.0***	***-73.7***	***-75.6***	***-77.4***	***-79.4***	***-81.4***	***-83.4***	***-205.9***	***-748.8***
Departmental													
Component 3: Improve public access to company reporting	-	*-2.0*	*-1.7*	*-1.5*	*-1.5*	*-1.5*	*-1.5*	*-1.5*	*-1.6*	*-1.6*	*-1.6*	***-5.2***	***-16.0***
Total – departmental	**-**	***-2.0***	***-1.7***	***-1.5***	***-1.5***	***-1.5***	***-1.5***	***-1.5***	***-1.6***	***-1.6***	***-1.6***	***-5.2***	***-16.0***
Total – expenses	**-**	***-69.0***	***-70.3***	***-71.8***	***-73.5***	***-75.2***	***-77.1***	***-78.9***	***-81.0***	***-83.0***	***-85.0***	***-211.1***	***-764.8***
Total (excluding PDI)	**-**	**-69.0**	**575.9**	**419.5**	**442.1**	**462.6**	**474.1**	**500.1**	**526.0**	**553.3**	**592.6**	**926.4**	**4,477.2**

(a) A positive number for the fiscal balance indicates an increase in revenue or a decrease in expenses or net capital investment in accrual terms. A negative number for the fiscal balance indicates a decrease in revenue or an increase in expenses or net capital investment in accrual terms. A positive number for the underlying cash balance indicates an increase in receipts or a decrease in payments or net capital investment in cash terms. A negative number for the underlying cash balance indicates a decrease in receipts or an increase in payments or net capital investment in cash terms.

.. Not zero but rounded to zero. - Indicates nil.

Table A2: Ending corporate tax avoidance – Memorandum item: Public Debt Interest (PDI) impacts – Fiscal and underlying cash balances ($m)[(a)(b)]

		2021–22	2022–23	2023–24	2024–25	2025–26	2026–27	2027–28	2028–29	2029–30	2030–31	2031–32	Total to 2024–25	Total to 2031–32
Fiscal balance	*PDI impacts*	-	*-1.0*	*4.0*	*12.0*	*20.0*	*30.0*	*41.0*	*54.0*	*70.0*	*88.0*	*110.0*	***15.0***	***428.0***
Underlying cash balance	*PDI impacts*	-	*-1.0*	*3.0*	*11.0*	*19.0*	*29.0*	*40.0*	*53.0*	*68.0*	*86.0*	*107.0*	***13.0***	***415.0***

(a) As this table is presented as a memorandum item, these figures are not reflected in the totals in the table above. This is consistent with the approach taken in the budget where the budget impact of most measures is presented excluding the impact on PDI. If the reader would like a complete picture of the total aggregate, then these figures would need to be added to the figures above. For further information on government borrowing and financing please refer to the PBO's online budget glossary[2].

(b) A positive number for the fiscal balance indicates an increase in revenue or a decrease in expenses or net capital investment in accrual terms. A negative number for the fiscal balance indicates a decrease in revenue or an increase in expenses or net capital investment in accrual terms. A positive number for the underlying cash balance indicates an increase in receipts or a decrease in payments or net capital investment in cash terms. A negative number for the underlying cash balance indicates a decrease in receipts or an increase in payments or net capital investment in cash terms.

\- Indicates nil.

[2] Online budget glossary – Parliament of Australia (aph.gov.au)