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Board of Taxation Secretariat
The Treasury – Sydney Office
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Attention: Mr Michael Atfield

Dear Michael

Post-Implementation Review of the Tax Transparency Code – Consultation Paper

Chartered Accountants Australia and New Zealand (CA ANZ) appreciates the opportunity to make a submission to the Board of Taxation (Board) on the Post-implementation Review of the Tax Transparency Code (the Code) consultation paper.

Background to the submission

At the request of the former Minister for Revenue and Financial Services, the Board is undertaking a post-implementation review of the Code to gather feedback and identify improvements in the context of global developments in the tax transparency landscape, with a focus on simplicity and usefulness of the disclosures.

As part of this review the Board has already conducted consultations with a range of stakeholders.

The purpose of the consultation paper is to seek views on a draft revised Code developed by the Board, as outlined in Annexure B to the consultation paper.

The key changes proposed to the Code are as follows:

- The Code provides minimum standards supplemented with best practice elements as opposed to optional elements;
- A new minimum standard covering a basis of preparation statement, including whether the Australian Accounting Standards Board (AASB) guidance has been followed, and if not, why not;
- A new minimum standard involving the reconciliation to ATO public data disclosures;

- Other enhancements to the minimum standards covering:
  - Reconciliations of accounting profit to income tax payable and to income tax paid in Part A of the Code,
  - Additional guidance on tax policies, strategy and governance in Part B of the Code,
  - Expanding the tax contribution summary in Part B of the Code,
  - Clarifying the international related party dealings summary in Part B of the Code;

- Best practice recommendations are incorporated into Part B of Code covering:
  - Material tax dispute disclosures not already disclosed in financial statements,
  - Structure and composition of the group including approach to tax structuring,
  - Approach to compliance with tax authorities.

The consultation paper also notes the following:

- No changes to the current 'large business' threshold to complete Part A & B of the Code (i.e. Australian turnover of A$500M or more), nor the 'medium business' threshold to complete Part A of the Code (i.e. Australian turnover of greater than A$100M but less than A$500M);

- Flexibility is retained on where the 'tax transparency report' information is published but it is expected the information would be published each year;

- The revised Code is not proposing to include disclosures of uncertain tax positions given that any such disclosures should be incorporated into financial statements from 2019;

- The revised Code continues to be directed towards 'general users' (e.g. community at large) and 'interested users' (e.g. shareholders, analysts, social group, media and politicians), rather than meeting the requirements of regulatory authorities;

- The Code continues to be voluntary and the Board continues to recommend against mandatory publication of OECD Country-by- Country reports (or excerpts).

Overall comments

CA ANZ is broadly supportive of the proposed incremental changes to the proposed Code, albeit we make some recommendations and observations in the detailed comments section of this submission.

The key submission points we wish to highlight are as follows:

- Interaction with the final decision on the government's procurement policy is important. If tax transparency reporting becomes a government procurement policy requirement, the Board's guidance on the Code should be revisited;
- The AASB's draft Appendix to the Code needs to be finalised contemporaneously;
- Further consideration should be given to the guidance surrounding some of the additional information proposed to be disclosed in a tax transparency report.

Detailed comments

Government procurement policy and the Code

The Government is currently considering whether to make compliance with the Code a mandatory or discretionary criterion in awarding major government procurement contracts.

In a separate consultation submission on the Government's procurement policy, CA ANZ did not recommend that compliance with the Code should become a procurement criterion due to the subjective nature of parts of the Code which would make it harder and slower to determine whether an entity can participate in the government procurement process. Clearly the Government may ultimately decide otherwise. If it did, the Code is effectively moving towards a defacto mandatory disclosure regime for some entities.

This may well challenge some of the thinking underpinning the proposed Code which often defaults to 'the preparer decides' when it comes to the detail. CA ANZ suspects that major suppliers to government will want to be assured they are 'Code compliant' to avoid governments, competitors, civil society, etc. suggesting otherwise and thus jeopardising important income streams. As a consequence, the Code and its guidance will certainly be more heavily scrutinised if this transpires and it may well generate further requests by taxpayers for modifications and clarifications after the Board's consultation period closes.

In short, if the Code does become a procurement criterion, there may well be new, conflicting demands from some taxpayers for greater certainty to be built into the guidance accompanying the Code.

CA ANZ recommends that:

- If a Government procurement policy decision is expected shortly and the final decision means the Code effectively becomes mandatory for some taxpayers, then the Board should consider conducting a second round of consultation.

If the Board concurs with this view, we recommend the Board releases for consultation:

- The final draft Code;
- The final draft Appendix to the Code which is being prepared by the AASB (refer submission point below);
- A new section of the Code providing a summary of the linkages between the Code with the final government procurement policy and what is now expected of major government suppliers (particularly those that are neither large or medium corporate businesses);
- Proposed start dates for the new Code and the procurement policy and any transitional considerations;
- Seek submissions on whether the guidance needs to be modified considering the Code may become a defacto mandatory code for some taxpayers.

CA ANZ's remaining submission points proceed on the basis that any Government decision as to whether the Code becomes a procurement policy criterion is not imminent. Thus, our comments are premised on the basis that the Code is an entirely voluntary regime.

AASB Appendix: Additional guidance on Part A disclosures under the Code

Under the proposed Code's minimum standard requiring a 'basis of preparation' statement, it will be necessary for preparers to indicate whether they have followed the AASB's guidance. This AASB guidance will ultimately be an Appendix to the Code which will mainly (but possibly not exclusively) deal with Part A disclosures under the Code and effective tax rate (ETR) presentations.

If the AASB guidance is not followed, preparers will need to explain the reasons for any departures from this guidance. Thus, the AASB guidance is an important element of the final Code.

Unfortunately, however, as part of the Board's current consultation process, any proposed changes to the previous AASB draft guidance has not been released contemporaneously for comment.

It is apparent from a perusal of earlier submissions in 2018 on the AASB's draft Appendix that several noteworthy suggestions were raised, including:

- Harmonising writing styles used in the AASB guidance and the main body of the Code; and
- Clarifying certain aspects of the AASB's draft Appendix (e.g. the calculation of, and minimising the number of, ETRs that might be disclosed; further guidance for certain tax consolidated groups and entities in tax losses, research and development claims, amended assessments and penalties).

It will also be important that the AASB's Appendix is complementary with the final changes incorporated into the Code.

CA ANZ recommends that:

- Consistent with the Board's approach, the AASB should seek views on the proposed changes to the Appendix to the Code.
- The AASB's draft Appendix to the Code needs to be finalised before the release by the Board of the new Code.
- The release of the final version of the Code should be accompanied by the final version of the AASB Appendix.

Best practice recommendation: Description of subsidiaries

The Code is proposing the following disclosures:

- Name and place of incorporation of all subsidiaries in the group (where not already disclosed in financial statements);
- Explanation of activities undertaken in low tax jurisdictions;
- The business' approach to the allocation of value between international related parties.

CA ANZ's views on these proposals are as follows:

- We acknowledge that the first two proposals noted above have often been regarded as a 'must have' by certain users of tax transparency reports;

- However, we do find it strange that materiality considerations that are sensibly applied elsewhere in the Code are now dispensed with in those two disclosures and we question the justification;

- Where financial statements are already disclosing information on the material subsidiaries, we also question whether there is any value in having a list of non-operating or nominal operating subsidiaries disclosed in a tax transparency report;

- We consider that what constitutes activities in a 'low tax jurisdiction' is open to widely different interpretations (e.g. should the diverted profits tax 'sufficient foreign tax' rule be used, or is less than a 15% headline rate the appropriate test, or is a some low ETR the benchmark);

- We question whether it is necessary to give much, if any, explanation of activities in nil or low tax jurisdictions if those subsidiaries are fully subject to accruals taxation back in Australia and thus fully within the Australian tax net;

- In respect of the value allocation disclosure, we question whether many of the intended users will understand the disclosure and we also suspect preparers are likely to revert to boiler plate, motherhood statements absent any ATO transfer pricing agreement.

CA ANZ recommends that:

- It should not be a best practice requirement that all subsidiaries in a group be disclosed, as it is more likely the compliance costs outweigh the disclosure benefits in most cases.
- Whilst we acknowledge activities in low jurisdictions are a concern of some users, this only reinforces our view that the Code should suggest an acceptable benchmark of low tax jurisdictions (e.g. a list of tax havens might be incorporated into the Code to guide preparers rather than having to list all entities).
- Where subsidiaries do exist in a jurisdiction on a nominated tax haven list, the Code could acknowledge that if such activity is fully subject to Australian tax, it should be of little concern and thus warrant little further comment.
- The value allocation commentary should not be a best practice requirement.

New minimum standard: Basis of preparation statement - assurance processes

We observe the proposed Code proceeds on the assumption that disclosures made within general purpose financial statements are subject to accounting standard compliance, including auditing compliance and thus the focus of this new minimum standard is separate tax transparency reports.

Whilst the assumption is true to some extent, the submissions to the AASB on its draft Appendix to the Code allude to the problems with disclosing non-IFRS financial information in financial statements and the inherent financial statement audit limitations on opining on such information. In addition, there was a question raised with the AASB as to why there is a need to explain whether a separate taxes paid report was audited or not, given they do not form part of the financial statement reporting process.

The proposed expansion of the Code may only encourage a move towards transparency reports that are separate from the financial statements which, on one view, is a little unfortunate in that the voluntary Code itself may drive behaviour (and potentially costs).

Nevertheless, it is already common practice for separate tax transparency reports to be prepared so in our view it is appropriate for their basis of preparation to be properly explained and thus we are supportive of a minimum standard.

However, the proposed Code then goes to mandate that the assurance processes undertaken should be explained. The proposed Code does not require that external assurance be obtained, but if the numbers are not audited, internal processes must be explained.

For groups currently preparing unaudited transparency reports or for groups considering whether to adopt the Code, the issue is whether this change is effectively making external audits 'the path of least resistance'. Obviously, unintentional increases in compliance costs should be avoided, where possible.

Accordingly, we recommend that the commentary in the final Code could point to acceptable internal processes such as the following:

- If financial information is largely sourced from already audited financial statements or ATO data sets;
- If internal audit functions have undertaken assurance processes; or
- If Board committees or the CFO have had responsibility oversight,

then such explanations might usefully explain why internal assurance processes are enough and an external audit unnecessary.

CA ANZ recommends that:

- The Code might provide a few brief examples of what the Board considers are appropriate internal assurance processes.

New minimum standard: Basis of preparation statement – materiality
Best practice recommendation: Significant tax disputes

Under the proposed Code, when preparing separate tax transparency reports, the 'basis of preparation' statement will contain some commentary around materiality. It seems implicit that this may or may not be the same materiality that is adopted for financial statement purposes. In talking with the Board, we understand the materiality for a tax transparency report might well be lower than the financial statements.

It also seems possible that there is more than one materiality gauge used or it is nuanced (e.g. a no adjustment outcome in a large compliance activity might warrant a brief mention but it should not follow all small adjustments against the taxpayer necessarily warrant some explanation just because a nil adjustment is mentioned). The basis of determining a materiality gauge(s) is appropriately left up to the preparer, albeit it should be disclosed in the basis of preparation statement.

Given other commentary in the proposed Code it appears this scope of materiality statement may be relevant in preparer's deciding on the following:

- Temporary and non-temporary differences disclosed in the income tax payable and paid reconciliations (Part A);
- Reconciliation items to the ATO data releases (Part A);
- What constitutes a significant tax dispute (Part B);
- Possibly aspects of tax policy, strategy and governance (e.g. what tax assurance regimes are explained, what ATO compliance activity outcomes are disclosed) (Part B);
- The granular detail disclosed in respect of other Australian taxes and imposts (Part B);
- Qualitative offshore related party dealings significantly impacting taxable income (Part B).

As noted above, the principle of 'the preparer can decide, but should disclose the basis of preparation' appears reasonable when it comes to materiality settings. Nevertheless, the Code may well benefit from the following:

- Providing more generic materiality guidance along the lines above;
- Having decided to require commentary on significant tax disputes in tax transparency reports (which clearly is a sensitive issue for most groups), we believe more guidance would be prudent around this disclosure. What constitutes a material tax dispute has been the subject of public disagreement in the recent past between the Commissioner and some taxpayers. Accordingly, tax transparency report clarity around materiality, particularly as it relates to tax disputes, is likely to be an important issue;
- Given the ATO and large corporates have in the past been able to collaboratively agree on materiality gauges in the context of reportable tax positions, the Board in conjunction with the ATO's Large Business Steering Group, could consider whether more explicit guidance is warranted or whether the current flexibility is preferred;
- The reference to significant tax disputes with other revenue authorities should be clarified to explain whether the focus is with respect to other Australian revenue authorities (this seems to be the intent given the surrounding commentary) as opposed to foreign tax authorities.

CA ANZ recommends that:

- The Board should consider incorporating further guidance into the Code on materiality, particularly in respect of tax dispute disclosures.

New minimum standards: A reconciliation of accounting profit to income tax payable and income tax paid and a reconciliation to ATO data sets

In this regard, we note the following:

- Financial statements and accompanying cash flow statements may disclose both tax payable and tax paid numbers as well as obviously a tax expense number;
- The ATO data release, however, only discloses tax payable; and
- Some tax transparency reports focus on 'Taxes Paid' reporting.

Accordingly, we think it is beneficial for tax transparency report users to be able to see a reconciliation from accounting profit to tax expense, to tax payable and to tax paid. Similarly, the reconciliation to the ATO data sets appears appropriate. The AASB's final Appendix to the Code might help reduce the associated compliance costs for preparer's by ensuring there are worked examples.

Nevertheless, the move to a more prescriptive Code with minimum standards and best practices poses new challenges for groups which include fiscally transparent entities (e.g. stapled structures).

Whilst it is true that section 4 of the proposed Code notes non-corporate entities can adapt the Code's principles, consideration should also be given to expanding the section 4 commentary to include the following:

- Minimum standards on ETRs are not relevant for partnerships and trusts;
- Acknowledging that other minimum standards such as reconciling to income tax payable/paid or to ATO data sets, would need to be modified for stapled structures, partnerships and trusts.

CA ANZ recommends that:

- The AASB's final Appendix to the Code might help reduce the associated compliance costs for preparers by ensuring there are worked examples for each reconciliation statement.
- In the introduction section of the proposed Code, the summary Table needs to be adjusted as it still refers to the minimum standard being a reconciliation to income tax paid or income tax payable (plus there is an asterisk that appears superfluous).
- The commentary discussing how non-corporate entities can adapt the Code's principles could be expanded to acknowledge that various minimum standards or best practices are either not relevant or need to be modified for stapled structures, partnerships and trusts.

Best practice recommendation: Outcomes of ATO compliance activities

Details of ATO tax compliance activity outcomes are a recommended best practice, with the example given of disclosing a 'risk rating' outcome.

We observe that the Code's reference to the use of risk ratings may have some spill-over effects into ATO and large business dealings when it comes to the process of assigning ratings.

If the ATO has not looked at a matter or has only undertaken some 'streamlined' review process it is likely the ATO may conservatively rate that matter and/or the taxpayer, even though no adjustments have resulted from the compliance activity. The greater the weight the Code places on risk rating disclosures, the greater the angst that will be generated for the ATO and large businesses in compliance activities and assigning final ratings.

Given the use of an ATO rating is merely used as one possible example of describing the ATO compliance outcome, the Board may consider this spill-over risk is not substantial. On the other hand, feedback we have already received suggests some corporates would have more rigorously challenged recent ATO risk ratings purely because of the proposed changes to the Code.

In any event, it would be worth inserting a proviso that the use of an ATO rating would need to be easily understood by the intended users, otherwise qualitative commentary may be a preferred way to describe compliance activity outcomes.

CA ANZ recommends that:

- The Board may wish to reconsider the existing commentary about disclosing risk rating outcomes.
- If the commentary is retained, it would be prudent to also note that the use of ATO risk rating descriptors needs to be easily understood by the users, otherwise qualitative narrative is to be preferred

If you wish to discuss our comments, please contact me on (02) 9290 5609 or via email at michael,croker@charteredaccountantsanz.com.

Yours sincerely

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Appendix

Chartered Accountants Australia and New Zealand

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