Corporate Tax Association

GROUP OF 100

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Inquiry into Treasury Laws Amendment (Combatting Multinational Tax Avoidance) Bill 2017

The Corporate Tax Association (CTA) and the Group of 100 (G100) which together represent 120 of the largest corporate taxpayers in Australia, welcome the opportunity to provide comments on the Treasury Laws Amendment (Combating Multinational Tax Avoidance) Bill 2016; Diverted Profits Tax (the DPT Bill) and the accompanying Explanatory Memorandum.

Background and Context

For the purposes of providing background and context to the development of the proposed DPT and the 100fold penalties measures we refer to the following:

- The CTA's submission on the DPT Discussion Paper (DP) released on Budget night, lodged on 17 June 2016

- The joint submission by the CTA and the G100 on the DPT Bill, lodged on 22 December 2016

- The CTA's submission on the proposed 100fold penalties measure in response to the DPT Bill, lodged on 18 January 2017

These submissions are reproduced at Appendices A, B and C.

We note that despite the significant concerns raised by the CTA, the G100 and others with the proposed DPT and 100fold penalties measures, those concerns remain largely unaddressed and are reflected in the DPT Bill.

Details of those concerns can be found in the accompanying submissions. For the purposes of the Committee's review of the DPT Bill, we have limited our comments to those matters we consider to be of the highest priority in terms of ensuring the proposed DPT and 100fold penalties measures have their intended effect.

1. The DPT legislation should make it explicit that the DPT is a provision of last resort

Despite some cosmetic changes to the DPT Bill and the accompanying EM on this point, it remains fundamentally unclear where the transfer pricing laws end and the DPT begins. This is particularly the case in the context of the transfer pricing reconstruction provisions in sec 815-130, which are yet to be tested. Given the transfer pricing laws are regarded by all who use them as necessarily "grey", the need to provide certainty as to where the line between the two provisions sits is crucial.

Ensuring the DPT is a provision of last resort is also crucial in the context of deterring the use of the DPT as leverage during transfer pricing disputes. The close resemblance between the proposed DPT and the transfer pricing provisions must not give rise to subjective assessments of a taxpayer's behavior taking precedence over whether the taxpayer in fact has a reasonably arguable position under the existing law.

In our view, the simplest and most effective way to do this is to make it explicit in the law that the DPT is a provision of last resort. The lowering of the Part IVA bar for the DPT (by using a 'principal' rather than 'dominant' purpose test), combined with its close relationship to transfer pricing demand that its use be legislatively limited to cases where all other relevant laws have been explored. Although we recognise the insertion of paragraph 1.18 into the EM as an attempt to address this point, the EM is not substitute for the law in this (or indeed any) circumstance.

Legislating this point would also provide an appropriate safeguard against the Commissioner applying the DPT before he or she has employed and exhausted all existing information gathering powers. On this point, serious consideration should be given to removing the last sentence of paragraph 1.38 of the EM, which states that "the Commissioner is not required to actively seek further information to reach a conclusion [that the DPT applies]."

In weighing up the importance of these points, we ask the Committee to consider the following question - what is to be gained by compliant taxpayers being unnecessarily caught up in the application of the DPT? In its current form, the DPT has the potential to apply to almost 60% of offshore transactions undertaken by companies operating in Australia, whose only potential protection is the sufficient economic substance test, which is fraught with interpretative difficulties. Without any legislative safeguard, corporates will have no choice other than to seek clarity on whether the proposed DPT applies to such transactions, which will come with unnecessary compliance costs and the use of limited internal resources. Australia's tax policy should strive for a better outcome than this.

2. The sufficient foreign tax test sets the bar too high

The sufficient foreign tax test, although intended to operate as a carve out, has the potential to impact all transactions involving a foreign related entity in a jurisdiction that imposes corporate income tax at a rate less than 24%. This essentially means that countries that are trading partners, rather than tax havens, will be tarred with the DPT brush.

Given this, we feel it necessary to once again state the following:

- The 80% test has been lifted from the UK DPT, where it applies to the current UK corporate tax rate of 20% (which equates to its application to jurisdictions with corporate tax rates of less than 16%.) The UK has flagged further cuts to its corporate rate over the next four years.

- Early indications from the US around corporate tax reform under the Trump administration would see all related party transactions with the US falling within the ambit of Australia's proposed DPT.

- According to the latest ABS data, the US and UK are still the two largest foreign investors into Australia as well being the two largest destinations for Australians investing overseas, making up about 45% of all investment flows.

- The 80% test and its application at 24% is said to align with Australia's proposed glide path to a 25% corporate income rate. Given the first decrease to the corporate tax rate under the proposed 10-year glide path will be to 27.5% in 2022-23, large corporates operating in Australia will be subject to the DPT at 24% whilst paying corporate income tax at 30% for a minimum of six years.

These facts stand in stark contrast with the Government's stated objective of "improving the competitiveness of the Australian tax system to support investment and growth."[1]

3. The DPT effectively ignores Australia's treaty obligations

Australia's long held reservation on Part IVA matters means that the inclusion of the DPT in Part IVA will essentially shield it from being overridden by tax treaties. This outcome has the perverse effect of protecting a provision which is designed to create the outcome that tax treaties are specifically aimed at preventing, that being double taxation.

Of most concern is the current position stated by Treasury in its consultation paper titled 'Australia's adoption of the BEPS Convention (Multilateral Instrument)' (released in November 2016) which confirms that at this stage, Australia intends to reserve mandatory binding arbitration from applying to Part IVA cases (and by extension to DPT assessments).

Mandatory binding arbitration is aimed at providing taxpayers with a process to refer disputes that have not been resolved through the established Mutual Agreement Procedure (MAP) process within two years to independent and binding arbitration. Mandatory binding arbitration is regarded as an integral part of the Multilateral Instrument for large corporates, given the changes imposed by its articles will most likely increase the chances of cross border tax disputes. To have a situation where a revenue authority can effectively by-pass mandatory arbitration via a provision that will very likely result in double taxation is of great concern. Given the potential outcomes under the proposed DPT, we suspect other countries may also take exception to its exclusion from binding MAP arbitration.

As stated in the CTA's submission on Treasury's consultation paper, we believe Australia should withdraw its reservation to exclude the DPT and allow taxpayers who are subject to a DPT assessment access to binding MAP arbitration.

Allowing DPT assessments to be excluded from binding MAP arbitration will create a scenario under which the Australian Taxation Office (ATO) could challenge standard transfer pricing transactions under the DPT and circumvent the possibility of binding MAP arbitration to resolve the dispute. Even if the ATO does not issue many DPT assessments, the sheer existence of that option will most likely come into play in terms of leveraging outcomes the context of complex, but legitimate transfer pricing disputes. Regardless of the context, it is simply inappropriate for binding MAP arbitration not to be available in the context of what will essentially be cross border transfer pricing matters.

4. The ATO must set strong and clear gateways around the application of the DPT

Whilst the policy intent of the DPT may be to prompt recalcitrant taxpayers to come forward, the inappropriate breadth of its current design will require non-recalcitrant taxpayers to gain clearance that the DPT does not apply given the onus of proof under the DPT is effectively shifted to them. Given the need for large corporates to manage their tax risks, as well as meet continuous disclosure and financial statement disclosure requirements around tax provisions and contingent notes, the DPT in its current form will place unprecedented pressure on taxpayers, and therefore the ATO to provide certainty on transfer pricing matters or "DPT clearance".

If the current pace of the resolution of transfer pricing disputes is anything to go by, the ATO is simply not equipped, in terms of resources to manage a significant increase in taxpayers seeking to manage and mitigate their transfer pricing risks. Placing an already limited resource under unnecessary pressure (in the sense of the DPT net being cast so wide as to waste limited ATO resources providing certainty to taxpayers who are currently complying with the transfer pricing laws) is nonsensical and runs counter to the apparent purpose of the proposed DPT.

In other words, the breadth of the proposed DPT will require the development of some method of fast tracking DPT matters and possibly a new process to resolve transfer pricing disputes via alternative dispute resolution processes. Increased resources devoted to the Advance Pricing Agreement (APA) program and/or the development of additional safe harbors for low risk transactions will be required. Whilst this may be viewed as a matter for ATO administration, in our view a process for "DPT clearance" with set timeframes enshrined in the law has some merit as an incentive for taxpayers and the ATO to accelerate resolution of matters or provide confirmation that the DPT does not apply to an arrangement.

Given the extremely harsh consequences associated with the application of the DPT we also consider it a priority to determine which transactions should be excluded from its operation. Clarity around such exclusions will also ensure that the DPT doesn't usurp current ATO practice in relation to the way it manages its compliance activities more broadly.

In our view the following arrangements or transactions should be excluded from the operation of the DPT:

- APAs and Annual Compliance Arrangements (ACAs)
- Transactions already disclosed to the ATO
- Existing safe harbors

Please refer to pages 8-10 of our joint submission (Appendix B) for further details around these exclusions.

5. The 100fold penalties measure reaches well beyond its stated intent

The application of this proposed measure should be limited to multinational companies who opt out of their reporting obligations. This objective aligns with the Government's announcement of the proposed measure in the 2016 Federal Budget.

As currently drafted the proposed measure goes well beyond this stated objective in the following ways:

- The definition of 'significant global entity' includes corporates who are controlled by Australian residents and only have Australian operations, where there is no potential loss of revenue from mispriced international related party transactions.
- It will apply to any approved form that may be required to be lodged under a taxation law and not solely returns such as income tax returns, BAS, PRRT or country by country reports which may have a bearing on the calculation of a tax liability. Such a wide application of a 100fold increase in penalties will subject large corporates to unnecessary risks around large penalties for inadvertent delays in lodging documents that are not in any way related to the calculation of an ultimate tax liability.

We recommend the following changes to the proposed measure to bring it into line with its stated objective:

- SGEs that are controlled by Australian residents and have no foreign operations should be excluded from the measure. The existing penalty regime operates as a sufficient deterrent for any non-compliance by domestic entities and should be left undisturbed by these changes.
- "Similar tax documents" should be limited to approved forms that are integral to the ATO in reviewing tax liabilities and should not apply to approved forms that are more in the nature of information. The latter group should remain subject to the existing FTL penalties.

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Over the past four years Australia has introduced 19 measures which have been ostensibly aimed at improving the integrity of the Australia's tax system, with a particular focus on international taxation[2]. Just last week an OECD working paper titled "Anti-avoidance rules against international tax planning" found Australia to be the highest ranking across 46 jurisdictions in terms of the main anti-avoidance rules in place in OECD and G20 countries.[3]

Whilst Australia should be proud of its record on corporate tax avoidance and BEPS, there must come a point at which we take stock of those achievements and ensure that any further proposals do not unduly encroach on Australia being viewed as a place that is open for business. On this point, we urge the Committee to consider what a provision like the proposed DPT means in terms of a small open economy reliant on foreign investment to drive growth.

If it is felt that Australia must take unilateral action in the BEPS space, despite it being at the forefront of global efforts to counter corporate tax avoidance, then it must at the very least ensure that such a measure only applies within carefully defined and clearly identified parameters.

In closing, we feel it is worth reiterating that the DPT in its current form is the most significant corporate tax integrity measure to be introduced into the Australian corporate tax system since the introduction of Part IVA in 1981. This fact, along with its interaction with the two most complex and therefore controversial provisions in our corporate tax law[4] should equate to all stakeholders treading carefully through its development and paying heed to the legitimate concerns of those that operate within it.

Should you wish to discuss any aspect of this submission in further detail, please do not hesitate to contact Michelle de Niese or Andrew Porter.

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[1] DP page 1
2 See Appendix D
3 http://www.oecd.org/eco/Anti-avoidance-rules-against-international-tax-planning-A-classification.pdf
4 Divisions 815 A and B (transfer pricing rules) and Part IVA (general anti avoidance rules)

APPENDIX A

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IMPLEMENTING A DIVERTED PROFITS TAX

The Corporate Tax Association (CTA), which represents the interests of 115 of the largest corporate taxpayers in Australia, welcomes the opportunity to provide comments on the paper released on 3 May 2016 titled "Implementing a Diverted Profits Tax" (DPT) (consultation paper). We note that the DPT is part of a package of measures in the 2016-17 Budget designed to ensure that large multinational businesses "are paying the appropriate amount of tax on the profits they make in Australia."

For the purposes of this submission it is worth reiterating the three objectives guiding the proposed introduction of the DPT (and other corporate tax proposals in the 2016-17 Budget):

- To improve the competitiveness of the Australian tax system to support investment and growth.
- To clamp down on corporate tax avoidance, ensuring fairness and levelling the playing field.
- To continue to lead reform of the international tax framework, including the implementation of the agreed OECD BEPS Action items.[5]

The CTA strongly supports each of these objectives.[6] We agree that a competitive tax system is crucial to supporting investment and growth in Australia. We also agree that corporate tax avoidance should be addressed and we support the Government's focus on combatting abusive arrangements that erode the Australian tax base. On BEPS, Australia has led the way in addressing the issues identified through the OECD BEPS project, with recent changes to our tax laws making our system one of the toughest corporate tax systems in the world from a tax integrity perspective. We also agree that Australia's ongoing response to BEPS should be aligned with the agreed OECD BEPS Action items.

However, reading these objectives in the context of the proposed DPT as set out in the consultation paper raise the following questions:

- How will a widely drawn tax, particularly one that effectively overrides Australia's recently strengthened and globally consistent transfer pricing rules and general anti-avoidance provisions, improve Australia's competitiveness?
- How will a tax that has the potential to apply to not only artificial and contrived arrangements but also to everyday commercial transactions ensure fairness and level the playing field?

- How does taking unilateral action at a time where countries are working together to implement the agreed OECD BEPS Action Items equate to leading reform of the international tax framework?

We explore these questions in more detail below.

Competitiveness – Looking at Both Sides of the Equation

The suggestion that the introduction of a DPT will improve the competitiveness of the Australian tax system is presumably linked to the Budget announcement that Australia will reduce the corporate income tax rate for large multinational businesses from 30% to 27.5% in 2022-23 and 25% in 2026-27. Although we commend the Government for pursuing a lower corporate rate, the time frame over which this will occur will mean that the DPT will not be accompanied by a reduced corporate tax rate for large companies for at least six years. So for six years, large corporates operating in Australia will be subject to the DPT whilst still paying corporate income tax at an uncompetitive rate. It is also worth noting that the Opposition and the Greens have confirmed they will not support a reduction in the corporate rate for large corporates, but presumably will support the introduction of a DPT.

This reality stands in stark contrast to the UK, from which Australia has borrowed the concept of a DPT. When the DPT was introduced in the UK in 2015, its corporate income tax rate was 20%, with the DPT 5% higher at 25%. This rate will fall to 19% for the year beginning 1 April 2017 and to 17% for the year beginning 1 April 2020. Australia's proposed DPT is set 10% higher than the underlying corporate rate. Whilst from a behavioral perspective this may be seen as a bigger incentive to have existing transfer pricing arrangements aligned with the arm's length principle, it impacts perceptions that Australia is really open for business relative to other jurisdictions. This is particularly important given Australia is a small open economy reliant on foreign investment to drive growth.

The UK Corporate Road Map, which was updated as part of its 2016 Budget, observes that "taxes should be low but must be paid."[7] Not only is Australia missing the first part of this equation, but we are weighing in too heavily on the second part, making our system increasingly difficult to comply with and operate within.

Finding the right balance between tax rates and integrity measures is integral to improving the competitiveness of our tax system. Australia's constant tinkering with the latter whilst not simultaneously addressing the former (as has been done in the UK) is seeing our system become less and less competitive over time.

Anti-avoidance measures that are targeted and clear in their effect will not affect the way that compliant businesses view the competitiveness of the regime. On the other hand, widely drawn anti-avoidance rules which have unpredictable outcomes will be detrimental to all companies operating in Australia. In our view, the proposed DPT falls into the 'widely drawn' category.

Addressing Corporate Tax Avoidance

In recent times both the Government and the Opposition have taken many steps to address corporate tax avoidance and ensure corporates are paying the appropriate amount of tax.[8] The consultation paper acknowledges this at paragraph 9, where it states that:

> *"Australia's strong integrity rules together with the MAAL addresses many arrangements of multinational entities designed to avoid Australian income tax."*

The CTA supports the Government's efforts to tackle corporate tax avoidance through the use of artificial or contrived arrangements. However, care must be taken not to confuse the tackling of such arrangements with managing the inherent complexities of large case audits.

It is on this basis that we raise our concern with the following statement, also at paragraph 9:

> *"However as a practical matter, these rules can be difficult to apply and enforce in certain situations – particularly where the taxpayer does not cooperate with the ATO during an audit."*

In our view, addressing corporate tax avoidance and the management of large case audits are unrelated matters. Determining whether a taxpayer is cooperating in an audit can be a rather subjective assessment. An ATO auditor may well consider a taxpayer is not cooperating with the ATO simply because they do not agree with the ATO's position. A taxpayer asking for the risk hypothesis supporting a lengthy information request could be seen by an ATO auditor as not cooperating with the ATO. These situations can and do arise during large scale, complex audits, which can often span several years. Transfer pricing cases are notoriously fact intensive and increasingly rely on sometimes reconciling conflicting expert evidence. To have a tax such as a DPT potentially applying to these situations is, in our view, beyond the supportable objective of addressing tax avoidance. Care must be taken to ensure the proposed DPT is not able to be used in circumstances where a subjective assessment of a taxpayer's behavior takes precedence over whether the taxpayer in fact has an arguable position under the existing law. In this respect we are strongly of the view there must be a safeguard in the law, not the reliance on administrative discretion, for the DPT to only be operative in exceptional circumstances.

A Proportionate Response to the Problem

As it stands, the proposed DPT potentially encompasses too many everyday commercial business arrangements and as a consequence will subject many businesses who do not engage in contrived arrangements to – at best - an additional layer of compliance and uncertainty. The discussion paper suggests that existing marketing hub, procurement hub, cross border intellectual property licensing or asset leasing arrangements and even commodity sale and purchase agreements[9] may be potentially affected by the proposed DPT.

If the Government's intention is to create a level playing field between those that operate within the law and those that operate on its fringes, then the parameters of the proposed DPT should be appropriately and narrowly framed so that it affects only the intended targets. In our view it would not be sufficient to set out these parameters in accompanying guidance – the potential implications of the application of a DPT require its parameters to be set within the law. To do otherwise would create unnecessary uncertainty and would see the potential application of the DPT reaching beyond its intended audience. Enshrining a robust gateway to the DPT in the law will also ensure that its potential application is only raised in appropriate circumstances, thereby addressing the concern that the ATO may utilise the DPT without due consideration of a taxpayer's position on what constitutes arms-length pricing of a transaction under accepted OECD guidelines that are part of the current transfer pricing law.

Implementation of the OECD BEPS Action items

Although the Government has stated that it remains committed to implementing the agreed OECD BEPS Action items, this is difficult to reconcile with the proposal to introduce the DPT. We remain concerned at the lack of restraint being practiced by some countries which are, for what appear to be politically motivated reasons, anticipating the outcomes of the OECD BEPS action plan. The proposed DPT can be seen in this light which may encourage other countries to take similar unilateral action resulting in a patchwork of complex uncoordinated legislation. Australia's proposed adoption of the UK's DPT, with its markedly different impact due to its application to our much higher corporate tax rate and interaction with our integrity measures, is a good example of such an outcome.

We would therefore strongly recommend that if the Government pursues the introduction of a DPT, a formal review be built into the DPT legislative process following the final BEPS outcomes, to ensure it remains fit for purpose and does not go further than the internationally agreed conclusions might reasonably regard as necessary.

We now turn to the specific features of the proposed DPT as canvassed in the consultation paper.

The Effective Tax Mismatch Requirement

The discussion paper confirms that an effective tax mismatch will exist where an Australian taxpayer (Company A) has a cross border transaction, or a series of cross border transactions, with a related party (company B) and as a result, the increased tax liability of Company B attributable to the transaction is less than 80% of the corresponding reduction *in Company A's tax liability.*

Put simply, the '80% rule' when applied to Australia's corporate tax rate of 30% has the potential to impact any transaction involving a related foreign entity in a jurisdiction that imposes corporate income tax at a rate less than 24%. This rule therefore has a much broader impact in Australia than in the UK, with the current UK tax rate ensuring their rules would not capture Switzerland, Singapore, Hong Kong or Ireland, which make up 40% of our related party transactions. Ignoring the carve out for small companies that is proposed, according to the most recent ATO data on related party transactions, almost 50% of related party transactions undertaken by companies operating in Australia could be covered by the DPT. Should the Australian corporate rate reduce to 25% from 2026-2027, the DPT would apply where the foreign country has a headline rate of less than 20%. We estimate this would still cover at least 42% of related party transactions.[10]

This outcome alone brings into question whether simply lifting the UK 'effective tax mismatch' test and applying it to Australia's corporate tax system produces the right outcome. Serious consideration should also be given to whether having a gateway test which applies to almost half of the related party transactions undertaken by companies operating in Australia sends the right message to foreign entities looking to invest in Australia.

The Insufficient Economic Substance Test

The second requirement for the DPT to apply is whether the transaction, or series of *transactions, or an entity's involvement in that transaction has insufficient economic* substance. Determination of whether there is insufficient economic substance will be based upon whether it is reasonable to conclude, based on the information available to the ATO at the time, that the transactions) was designed to secure the tax reduction.

Although there is very little detail in the consultation paper on how this requirement will work in practice, there appears to be significant overlap between it and Australia's transfer pricing rules, in particular the reconstruction provisions. The following statement at paragraph 15 of the discussion paper appears to confirm this:

> *"Australia's DPT will provide the ATO with* more options to reconstruct the alternative arrangement on which to assess the diverted profits where a related party transaction *is assessed to be artificial or contrived."*

On this point it is important to note that the recently redrafted reconstruction provisions in Australia's transfer pricing rules are largely untested. It is also worth noting that the 'insufficient economic substance test' in the context the UK DPT, although effectively in operation, has also not yet been tested as those companies to which the DPT can potentially apply have only just started lodging their relevant tax returns. Without any experience as to how either of these measures work in practice, it is difficult to envisage how Treasury or the ATO will be able to provide clear guidance on how this test should operate.

"Reasonable to conclude"

The adoption of the term "reasonable to conclude" is also cause for concern, as it is undefined term that varies from those used in existing anti-avoidance rules, such as the Multinational Anti Avoidance Law (MAAL) (which uses a principal purpose test) and Part IVA (which employs a dominant purpose test). It is also unclear whether this test is objective or subjective. In our view the DPT test should be set at a higher level than the MAAL, given the significant implications associated with the DPT being imposed. On this basis, consideration should be given to making the insufficient economic test an objective dominant purpose test, thereby aligning it with Part IVA.

"Based on information available at the time"

The apparent ability for the ATO to conclude that a transaction lacks economic substance "based on the information available at the time" is also a little alarming. Although the CTA does not condone foreign multinationals withholding information from the ATO, there are instances where some offshore data that the ATO seeks simply does not exist (for example, segmented accounts of a global business). Although we understand that this measure is aimed at encouraging taxpayers to provide timely and relevant information on offshore related party transactions, some sensible checks and balances need to be put in place to ensure that the DPT cannot be triggered simply because a multinational is unable produce certain documents. In saying this, we acknowledge that there should be an expectation that a taxpayer will assist the ATO in its inquiries in a constructive manner and will not withhold information that is in existence or is attainable from an offshore associate.

Who is caught by the DPT?

Given the extremely harsh consequences associated with the application of the DPT we consider it a priority to determine who, or perhaps more accurately which transactions, should be excluded from the operation of the DPT.

In our view the following arrangements or transactions should be excluded from the operation of a DPT:

1. Advance Pricing Agreements (APAs) and Annual Compliance Arrangements (ACA)

Where a company has entered into an APA with the ATO in relation to the arrangements in question or is in discussions with the ATO with a view to reaching an APA or has similar arrangements covered by an ACA, that arrangement should be excluded from the ambit of a DPT. An 'APA/ACA gateway' could be structured such that the proposed DPT could still apply in the event that facts relevant to the basis for the APA/ACA, and clearly identified as such, are not subsequently reflected in the commercial reality.

There should also be provision to allow existing APAs to be updated following appropriate discussions with the ATO to include consideration of the proposed DPT without requirement for an entirely new APA application process to be followed. That said, we believe that the ATO should make clear that existing APAs/ACAs (assuming there is no change in the factual basis) are sufficient to exclude the arrangements covered from the proposed DPT, since in agreeing to the APA/ACA the ATO will have been satisfied that the arrangements to which the APA/ACA apply are not contrived and that Australia is appropriately compensated for the specific Australian functions and assets.

APAs/ACAs signed after the introduction of a DPT should include a specific clause confirming the DPT has been considered and is not in point. Guidance would need to be updated to reflect this position.

2. Transactions already disclosed to the ATO

Where a company has already disclosed transactions/arrangement to the ATO in relation to other parts of the Tax Act or as part of an ongoing open dialogue under a pre compliance review and the ATO has concluded that the arrangement is low risk or that it has adequate information to make any necessary assessment, that transaction/arrangement should be excluded from the operation of the proposed DPT. The foregoing is on the basis that there has been no material change to the facts and circumstances.

Such an exclusion is necessary as the DPT in its proposed form could apply simply because the ATO disagrees with the transfer pricing adopted by a company. This is the case even where there is no recharacterisation (because the structure is not contrived), the company has disclosed all relevant information to the ATO and detailed transfer pricing documentation has been prepared to support the transfer pricing. To ensure the DPT is only utilised by the ATO to deal with taxpayers who transfer functions, assets or risks to offshore related parties using artificial or contrived arrangements to avoid Australian tax and who are uncooperative in their dealings with the ATO[11], it is important that ongoing disputes where full disclosure has already been made do not trigger a potential notification for DPT.

3. CFC rules

Transactions that are subject to the CFC rules where full attribution is made should be excluded from the operation of a DPT.

4. Safe Harbours

Transactions that are covered by the following safe harbours should be excluded from the operation of a DPT:

- 5% mark-up per OECD guidelines for low value service arrangements
- ATO transfer pricing documentation safe harbours
- Existing and future Country by Country local file reporting exclusions (for example, less than $2 million of related party dealings or 2% of related party transactions)

5. Related Party Transactions where there is no control of the outcome

Similar to the operation of the MAAL as recently enacted, the DPT should only apply to related party transactions where there is control of the transfer pricing outcome.

Interactions with other Parts of the Tax System

There are numerous overlaps between the proposed DPT and Australian tax and international law which will need to be worked through. These include but are not limited to treaties, Divisions 815-B and 815-C, Part IVA and other specific anti-avoidance provisions (including the MAAL).

Interactions between proposed law and old law is often an issue that is left to the last stages of consultation, primarily because of the inherent difficulties associated with making laws which seemingly overlap with each other work cohesively together. We urge those responsible for working through these interactions to engage constructively and openly with the corporate community to ensure that these issues are worked through at an early stage and that alignment between the various measures are adhered to where possible.

One particular area of interaction worth noting is the proposed DPT's interaction with the thin capitalisation rules. The consultation paper notes at paragraph 34 that where the debt levels of a significant global entity fall within the thin capitalisation safe harbour (which we assume is either the 60% asset test or the world wide gearing test), only the pricing of the debt and not the amount of the debt will be taken into account in determining any DPT liability. This statement presumably means that where the debt levels of a significant global entity fall outside the thin capitalisation safe harbor, such as the application of the arm's length debt test, then both the pricing and the level of debt could be taken into account in determining any DPT liability. Clarification of this point should be provided at the early stages of consultation.

Despite the number of disputes arising in recent times around the price of debt, the ATO is yet to provide any guidance to corporate taxpayers to assist in determining whether their pricing of debt is acceptable. If the proposed DPT is to apply to the pricing of debt, there will be a concerted and justified push from the corporate community for the ATO to provide an accessible, timely process through which corporate taxpayers can gain certainty on their positions in this area. In our view safe harbour interest rates would be the most effective means to achieve this outcome.

Resourcing and mechanisms for dealing and resolving DPT matters

One of the key issues with transfer pricing disputes relative to other tax disputes is they tend not to be binary "yes/no" issues, with arm's length pricing generally being within a range. With DPT it is a design feature that assessment can issue quickly, and must be resolved, at least at first instance within 12 months, but then subject to normal dispute resolution processes. Whilst the design of the DPT may be a behavioral response that recalcitrant taxpayers come forward, it is also the case that non recalcitrant taxpayers will also come forth to discuss wanting clearance that the DPT does not apply given the onus of proof under the DPT has effectively changed. This is particularly relevant given continuous disclosure requirements and financial statement disclosure requirements around tax provisions and contingent notes. In this regard the acceleration of transfer pricing matters for resolution or "DPT clearance" will be heightened.

In our view, this will require some fast tracking of DPT matters and possibly a new process to resolve transfer pricing disputes via alternative dispute resolution processes, increased resources devoted to APAs and/or the development of additional safe harbours for low risk transactions. Whilst this may be viewed as a matter for ATO administration, in our view a process for "DPT clearance" with set timeframes enshrined in the law has some merit as an incentive for taxpayers and the ATO to accelerate resolution of matters or provide confirmation that the DPT does not apply to an arrangement.

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Should you wish to discuss any aspect of this submission in further detail, please do not hesitate to contact myself or Paul Suppree of this office.

We look forward to engaging constructively with both Treasury and the ATO on the issues raised above.

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[5] Consultation paper page 1
[6] http://corptax.com.au/building-a-strong-corporate-tax-system/
[7]https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/509249/business_tax_road_map_final2.pdf
[8] http://sjm.ministers.treasury.gov.au/media-release/003-2015/
[9] https://www.allens.com.au/pubs/tax/fotax13may16.htm
[10] Some UK transactions may be subject to the DPT when the UK rate reduces to 17% by 2020. However as the banking and oil and gas sectors are subject to an additional supplementary tax that increases the effective rates of tax to 25% and 27% respectively, some transactions with the UK would likely remain outside the operation of the DPT.
[11] Consultation paper paragraph 12

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APPENDIX B

22nd December 2016

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Diverted Profits Tax

The Corporate Tax Association (CTA) and the Group of 100 (G100) which together represent over 120 of the largest corporate taxpayers in Australia, welcome the opportunity to provide comments on the Treasury Laws Amendment (Combating Multinational Tax Avoidance) Bill 2016: Diverted Profits Tax (the DPT Bill) and the accompanying Explanatory Memorandum (EM). We also acknowledge the recent consultation session held on 12 December 2016 with Treasury and ATO officials on the DPT Bill and its potential administration, where a number of concerns with the proposed DPT Bill and EM were raised and discussed.

1. Background and Context

For the purposes of providing some background and context to the development of the proposed DPT we refer to the CTA's submission on the DPT Discussion Paper titled Implementing a Diverted Profits Tax (DP) dated 3 May 2016. That submission is reproduced at Appendix A. Despite the significant concerns raised in that submission around the proposals put forward in the DP, those concerns remain largely unaddressed and are reflected in the DPT Bill. As such, the issues raised in that submission should be considered in the context of the issues canvassed below.

The DPT in its current form is the most significant corporate tax integrity measure to be introduced into the Australian corporate tax system since the introduction of Part IVA in 1981. This fact, along with its interaction with the two most complex and therefore controversial provisions in our corporate tax law[12] should equate to all stakeholders treading carefully through its development and paying heed to the concerns of those that operate within the corporate tax system to ensure that it only applies within carefully and clearly defined parameters.

Instead, we have been through a consultation process during which the vast majority of concerns raised have been ignored or overlooked, leaving us with a proposed anti-avoidance law that will technically apply to almost 60% of offshore transactions undertaken by companies operating in Australia whose only potential protection is an exclusion that is virtually indecipherable. These are realities and should not be dismissed as issues that can be managed through non-binding guidance.

The following observations are made in the context of understanding that the DPT will, in some form or another, be introduced in 2017. We ask that this acknowledgement be taken as an assurance that our comments are reflections of only the most significant threshold issues relating to the DPT, and as such should be taken seriously.

2. The purpose of the DPT should be clearly defined in the legislation

Given the outcomes associated with the application of the DPT, it is imperative that its purpose be set out in the legislation in terms that are clear and widely understood.

Not only is the DPT currently without a clearly defined purpose, sec 177H further confuses its potential application by employing the following untested concepts:

- "Principal purpose" (rather than "dominant purpose" as used in Part IVA)
- "Tax benefits" and "reduction of foreign tax liabilities" (like sec 177DA but unlike sec 177D)
- "Reasonable to conclude" (rather than it "would be concluded" as used in Part IVA)

The use of these terms or principles significantly lower the bar in terms of the traditional use of Part IVA as a provision of last resort (see further below), thereby making a clear objects provision for the DPT even more necessary.

Several attempts have been made in the EM to describe the purpose of the proposed DPT.[13] These statements range from "applying to profits that have been artificially derived from Australia", to "providing the Commissioner with extra powers to deal with taxpayers who transfer profits to offshore associates using arrangements entered into or carried out with a principle purpose of avoiding Australian tax."

The application of a provision of this magnitude cannot be left to a few vague, and in some cases, incompatible statements in an EM. The DPT legislation itself must state exactly what the DPT is aimed at. If the Government's intention is to create a level playing field between those that operate within the law and those that operate on its fringes, then the parameters of the proposed DPT must be appropriately and narrowly framed so that it affects only the intended targets. Just as the consequences of the DPT applying to taxpayers are made explicit, so too should its intended application.

3. The DPT legislation should make it explicit that the DPT is a provision of last resort

One of the primary concerns with the proposed DPT is that is it profoundly unclear where the transfer pricing laws end and the DPT begins. This is particularly the case in the context of the transfer pricing reconstruction provisions in sec 815-130, which are yet to be tested. Given the transfer pricing laws are regarded by all who use them as necessarily "grey", the need to provide certainty as to where the line between the two provisions sits is crucial.

Ensuring the DPT is a provision of last resort is also crucial in the context of deterring the use of the DPT as leverage during transfer pricing disputes. The close resemblance between the proposed DPT and the transfer pricing provisions must not give rise to subjective assessments of a taxpayer's behavior taking precedence over whether the taxpayer in fact has a reasonably arguable position under the existing law.

In our view, the simplest and most effective way to do this is to make it explicit in the law that the DPT is a provision of last resort. The lowering of the Part IVA bar (as detailed above) means the mere insertion of the DPT into Part IVA falls well short of providing the necessary level of certainty on this point.

Legislating this point would also provide an appropriate safeguard against the Commissioner applying the DPT before he or she has employed and exhausted all existing information gathering powers.[14]

4. The sufficient foreign tax test should be narrowed and clarified

The sufficient foreign tax test, although intended to operate as a carve out, has the potential to impact all transactions involving a foreign related entity in a jurisdiction that imposes corporate income tax at a rate less than 24%. This essentially means that countries that are trading partners, rather than tax havens, will be tarred with the DPT brush.

Although we acknowledge the Government's apparent commitment to the 80% test, we feel it necessary to reiterate the following points:

- The 80% test has been lifted from the UK DPT, where it applies to the current UK corporate tax rate of 20% (which equates to its application to jurisdictions with corporate tax rates of less than 16%.) The UK has flagged further cuts to its corporate rate over the next four years.
- Early indications from the US around corporate tax reform under the Trump Administration would see all related party transactions with the US falling within the ambit of Australia's proposed DPT.
- The 80% test and its application at 24% is said to align with Australia's proposed glide path to a 25% corporate income rate. Given the first decrease to the corporate tax rate under the proposed 10-year glide path will be to 27.5% in 2022-23, large corporates operating in Australia will be subject to the DPT at 24% whilst paying corporate income tax at 30% for a minimum of six years.

These facts stand in stark contrast with the Government's stated objective of "improving the competitiveness of the Australian tax system to support investment and growth."[15]

Aside from the 80% threshold, it is unclear how the proposed sufficient foreign tax test will apply to the foreign tax position of the relevant foreign entity. Design features of different jurisdictions that have been long accepted should be recognised and respected when determining the foreign tax position of impacted entities. To this end, clarity around the application of the following should be provided:

- Withholding taxes
- Losses
- CFC or equivalent provisions
- Tax consolidation type regimes
- Entities that are treated as fiscally transparent

5. More guidance on the sufficient economic substance test is needed

The proposed DPT contains a 'sufficient economic substance' test in section 177L which, alongside the sufficient foreign tax test, will apply as an exclusion to the application of the DPT. Given the current breadth of the sufficient foreign tax test (as canvassed above) section 177L will be the provision that does the 'heavy lifting' in terms of providing certainty for large multinationals who have related party dealings in jurisdictions with corporate income tax rates below 24%. On this basis, it is critical that the legislation implementing the 'sufficient economic substance' exclusion is drafted in a clear and comprehensive way. This is particularly the case because the structure of the provisions as presently drafted means the exclusion operates to remove the need to further consider potentially more complex and intricate parts of the DPT such as whether the principal purpose test is met.

As presently drafted, proposed section 177L briefly provides that the DPT will not apply if the income derived, received or made as a result of the scheme by each relevant entity *reasonably reflects the economic substance of the entity's activi*ties in connection with the scheme. This wording needs to be expanded to provide further guidance on the precise intended exclusion to the DPT. In doing this, the following points should be addressed:

The focus of the sufficient economic substance test should be on the arrangement

We believe the more appropriate way to draft the exclusion is to focus on the substance of the arrangement rather than only on the income derived. Adopting this approach would ensure that the intent of the provision (which is to exclude arrangements from the DPT if they have substance rather than if only one aspect of the arrangement (i.e. the income) has substance matching the activities) is reflected in the law.

Paragraph 1.57 of the EM provides a good summation of this point:

'Consequently, if a multinational entity operating in Australia structures its affairs in a way that reasonably reflects their economic substance, the sufficient economic substance test will operate so that the DPT will not apply.'

The focus should be on all aspects of the arrangement

The exclusion as currently drafted only applies if the income derived reflects the economic substance of the activities. We strongly disagree with this point and therefore with the comments in the EM that a distinction needs to be drawn between "active" and "passive" activities.

Firstly, it is often difficult to determine whether an activity is active or passive. For example, whilst the payment of a royalty, dividend or interest is clearly a passive activity from the payer's perspective, it is not as clear whether a payment of a management fee to a head office for services is a passive or active activity.

Secondly, the focus should be on the broader arrangement and the entity's circumstances in that context. A broader consideration of the arrangement that includes the activities, assets and risks of the parties must be adopted to determine sufficient economic substance.

Guidance on determining economic substance should be provided in the legislation

The legislation should make it clear that where the non-tax financial benefits of the arrangement exceed the financial benefit of the tax reduction, the arrangement will be taken to have sufficient economic substance. The proposed sec 177L does not contain any wording to reflect this point. We regard this as an integral part of an economic substance test and therefore should be reflected in the law. Arrangements can be validly entered into for a range of reasons, including financial non-tax factors. In our view, the legislation should require consideration of these factors to ensure that such arrangements fall outside the scope of the DPT.

Examples of these non-tax factors are given in the UK guidance to their DPT equivalent and recognise that the substance test is a test of the commerciality of the transaction, the value it adds in terms of both its direct and indirect effects and whether it is entered into mainly for tax or other commercial reasons. The UK guidance includes examples relating to:

- the functions or activities of a new company's staff taking into account all accounting periods for which the transaction(s) will have effect (e.g. by providing financial projections showing the productivity and efficiency savings the group expected to achieve at the time a technical support centre was established); and
- non-tax reasons for wanting to hold assets in one place (being simpler and more efficient in terms of the number of people needed to support the operation).

This type of further guidance should be included by way of examples in the EM.

The sufficient economic substance test should explicitly reference the OECD Transfer Pricing Guidelines

We agree with the comments in the EM that in determining economic substance, consideration should be given to the guidance in the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (Guidelines). Given the clear intention in the EM that the Guidelines should be applied in the context of the DPT, they should be reflected in the DPT legislation.

The simplest way of doing this would be to include in sec 177L a reference to the Guidelines relevant for sec 815-135 purposes. Adopting this approach will not only make the intention of their inclusion clear but will also ensure the reference to the Guidelines remains up to date and includes any published revisions to the Guidelines, such as the October 2015 updates.

6. The DPT effectively ignores Australia's treaty obligations

Australia's long held reservation on Part IVA matters means that the inclusion of the DPT in Part IVA will essentially shield it from being overridden by tax treaties. This outcome has the perverse effect of protecting a provision which is designed to create the outcome that tax treaties are specifically aimed at preventing, that being double taxation.

Further to this point, and assuming Australia in adopting the Multi-lateral Instrument (MLI) reserves mandatory arbitration from applying to Part IVA cases (and by extension to DPT assessments) the ATO could in practice challenge standard transfer pricing transactions under the DPT and circumvent the possibility of mandatory arbitration to resolve the dispute. Even if the ATO does not issue many DPT assessments, the sheer existence of that option will undoubtedly come into play in the context of complex, but legitimate transfer pricing disputes.

Mandatory arbitration is regarded as an integral part of the MLI for large corporates, given the changes imposed by its articles will most likely increase the chances of cross border tax disputes. To have a situation where a revenue authority can effectively by-pass mandatory arbitration via a provision that will very likely result in double taxation is of great concern. Given the potential outcomes under the proposed DPT, we suspect other countries may also take exception to its exclusion from mandatory arbitration.

The lack of restraint being practiced by Australia in seeking to introduce an integrity measure that has the potential to not only impact taxpayers who are complying with the law but also to exclude those taxpayers from seeking an independent and binding view on its application is alarming.

If the significant concerns already canvassed in this submission and the CTA's submission at Appendix A are not enough to convince the Government that it must enshrine robust gateways in the DPT law, its interaction with Australia's commitment to the MLI certainly should.

7. Interactions between the DPT and the thin capitalisation rules

The DPT Bill and EM are silent on the proposed DPT's interaction with the thin capitalisation rules. This is despite the issue being addressed at paragraph 34 of the DP which states that "where the debt levels of a significant global entity fall within the thin capitalisation safe harbor, only the pricing of the debt and not the amount of debt will be taken into account in determining any DPT liability."

At the very least, it should be made clear that the DPT will not be used to challenge amounts of debt within the thin capitalisation limits.

On interest rates, we note that both the OECD BEPS project and the Australian Courts are currently in the process of determining the calculation of interest rates under the transfer pricing guidelines and Australian transfer pricing laws. Given this, further consideration should be given to aligning Australia's proposed DPT with the UK rules, which carve loan relationships out of the DPT.

In any event, whilst we acknowledge that there may be transactions that increase debt levels that may be considered artificial or contrived, such transactions should be dealt with under the "standard" Part IVA provisions which require a dominant purpose of creating a tax benefit rather than the DPT which employs the looser "principal purpose" test. For example, related party borrowing at an arm's length interest rate to fund a capital outlay may have a dominant purpose of funding the acquisition of plant and equipment. However, the fact that interest is tax deductible may be regarded as a principal, though not dominant, purpose behind the transaction. As the rules are drafted, and all other things being equal, such an arrangement would theoretically be caught by the DPT even though debt levels may be within the thin capitalisation safe harbour rules and the interest rate is arm's length.

8. The 'reasonable to conclude' test should be aligned with the Part IVA test

As noted in section 2, the DPT provisions depart from Part IVA's "would be concluded" test in its use of the term "reasonable to conclude." There is no specific legislative guidance in the DPT Bill or the EM on how the "reasonable to conclude" test is to be applied. This is despite the test applying to both the DPT gateways and exclusions.

The only relevant reference to the test appears to be in paragraph 20 of the EM, which states:

"The Commissioner's ability to make a reasonable conclusion is not prevented by a lack of, or incomplete information provided by the taxpayer. Further, the Commissioner is not required to actively seek further information to reach a reasonable conclusion."

Leaving aside for a moment the absurdity of not requiring the Commissioner to actively seek further information from a taxpayer to reach a reasonable conclusion in the context of applying the DPT[16] paragraph 20 seems to suggest that the reasoning behind employing the "reasonable to conclude" test is to ensure the Commissioner can invoke the DPT on the basis of information that would not otherwise be considered to be a sufficient for the purposes of making an assessment.

If the concern around the Commissioner not being able to make an assessment based on limited information is the primary reason behind adopting the lesser test, the "would be concluded" test could simply be followed by the words "based on the information made available to the Commissioner." This test, when combined with a safeguard around the employment and exhaustion of all information gathering powers[17], would allow the Commissioner to issue DPT assessments on limited information whilst ensuring the stronger, more appropriate "would be concluded' test applied to the DPT gateways and exclusions.

Regardless of whether the DPT employs a "reasonable to conclude" or a "would be concluded" test, the EM should make it clear that the internal review processes must include some third-party involvement. Although there are references to the process behind issuing a DPT assessment following a similar approach to that taken for other anti-avoidance rules, it is not clear that the Commissioner's internal review processes before issuing a DPT assessment will involve non ATO staff with transfer pricing experience. In our view a panel similar to the current General Anti Avoidance Review panel (which should include a third-party transfer pricing expert), would be critical in ensuring reasonable conclusions around the operation of the DPT. A robust review process for the DPT is also important given the limited time to pay the DPT assessment and that the issuing of an assessment, even if disputed, would have market disclosure and financial statement implications.

9. DPT assessment and review processes should be more closely aligned with existing rules

The proposed administrative and procedural measures within the DPT are completely out of step with the ATO's already considerable assessment and review powers. Although it is understood that some modification to the current assessment and collection timetable is regarded as an essential component of the DPT in terms of encouraging affected taxpayers to modify behaviours, this in no way justifies a complete departure from existing assessment and payment policy settings. For example, there is no obvious reason why the DPT should be subject to a different time period than that provided for Part IVA matters (7 years compared to 4 years) or why the right of review period has been halved from 60 to 30 days.

The proposed requirement for taxpayers to pay a DPT assessment within 21 days with no right of objection for 12 months (and no appeal to the Administrative Appeals Tribunal) is draconian, to say the least. There is also no indication of how the ATO will administer these proposed changes, and whether its use of those powers will be appropriately monitored. Handing such powers to an administrator who is also under significant pressure to collect additional revenue without any structured checks and balances is highly inappropriate, particularly in the context of the breadth of the proposed DPT.

Perhaps a compromise to the current position might be that once a DPT assessment is made, the 12-month review period commences, with payment to be made if the ATO and an appropriately structured DPT panel (as referred to in section 8) determines that it is a valid assessment. Only at that stage would the taxpayer be compelled to pay the assessment, which would still place the ATO in a position of strength in the sense of holding the payment, but would place the taxpayer on a more reasonable footing in terms of being able to pursue the matter through the Federal Court. Also relevant to this point is clarity around whether 50/50 arrangements would be available. As with the changes to the time period for issuing assessments and review periods, there is no reason why the well-established 50/50 arrangement should not be available.

Related to the 12-month review period is the problematic proposal that evidence not provided to the Commissioner within that period would not be admissible in Court proceedings. This provision is clearly trying to address scenarios where a taxpayer produces relevant information or evidence that it has had on hand at a later point. This proposal is however completely unreasonable in situations where information has been outside the custody or control of the taxpayer or was not in existence during the 12-month period (such as expert evidence). This proposal also clashes with the current structure of the proposed DPT, under which the Commissioner is not required to notify the taxpayer of the material required.

In summary, the proposed changes to the assessment and review processes under the proposed DPT are largely unjustified and should be reconsidered.

10 The breadth of the proposed DPT brings into question the ATO's ability to manage and resolve potential DPT matters

One of the key issues with transfer pricing disputes relative to other tax disputes is they tend not to be binary "yes/no" issues, with arm's length pricing generally being within a range. A design feature of the DPT is that an assessment can be issued quickly and must be resolved, at least at first instance, within 12 months, and only then be subject to normal dispute resolution processes.

Whilst the policy intent of the DPT may be to prompt recalcitrant taxpayers to come forward, the inappropriate breadth of its current design will require non-recalcitrant taxpayers to gain clearance that the DPT does not apply given the onus of proof under the DPT is effectively shifted to them. Given the need for large corporates to manage their tax risks, as well as meet continuous disclosure and financial statement disclosure requirements around tax provisions and contingent notes, the DPT in its current form will place unprecedented pressure on taxpayers, and therefore the ATO to provide certainty on transfer pricing matters or "DPT clearance". If the current pace of the resolution of transfer pricing disputes is anything to go by, the ATO is simply not equipped, in terms of resources (and possibly expertise) to manage a significant increase in taxpayers seeking to manage and mitigate their transfer pricing risks. Placing an already limited resource under unnecessary pressure (in the sense of the DPT net being cast so wide as to waste limited ATO resources providing certainty to taxpayers who are currently complying with the transfer pricing laws) is nonsensical and runs counter to the apparent purpose of the proposed DPT.

In other words, the breadth of the proposed DPT will require the development of some method of fast tracking DPT matters and possibly a new process to resolve transfer pricing disputes via alternative dispute resolution processes. Increased resources devoted to the APA program and/or the development of additional safe harbours for low risk transactions will be required. Whilst this may be viewed as a matter for ATO administration, in our view a process for "DPT clearance" with set timeframes enshrined in the law has some merit as an incentive for taxpayers and the ATO to accelerate resolution of matters or provide confirmation that the DPT does not apply to an arrangement.

11 Additional carve outs by transaction type are needed

Given the extremely harsh consequences associated with the application of the DPT we consider it a priority to determine which transactions should be excluded from its operation. Clarity around such exclusions will also ensure that the DPT doesn't usurp current ATO practice in relation to the way it manages its compliance activities more broadly.

In our view the following arrangements or transactions should be excluded from the operation of a DPT:

- Advance Pricing Agreements (APAs) and Annual Compliance Arrangements (ACAs)

Where a company has entered into an APA with the ATO in relation to the arrangement in question or is in discussions with the ATO with a view to reaching an APA or has similar arrangements covered by an ACA, that arrangement should be excluded from the ambit of a DPT. An 'APA/ACA gateway' could be structured such that the proposed DPT could still apply in the event that the facts relevant to the basis for the APA/ACA are not subsequently reflected in the commercial reality.

There should also be provision to allow existing APAs to be updated following appropriate discussions with the ATO to include consideration of the proposed DPT without requirement for an entirely new APA application process to be followed. That said, we believe the ATO should make it clear that existing APAs/ACAs (assuming there is no change in the factual basis) are sufficient to exclude the arrangements covered from the proposed DPT, since in agreeing to the APA/ACA the ATO will have been satisfied that the arrangements to which the APA/ACA apply are not contrived and that Australia is appropriately compensated for the specific Australian functions performed, assets employed and risks assumed.

APAs/ACAs signed after the introduction of a DPT should include a specific clause confirming the DPT has been considered and is not in point. Guidance would need to be updated to reflect this position.

- Transactions already disclosed to the ATO

Where a company has already disclosed transactions/arrangements to the ATO in relation to other parts of the Tax Act or as part of an ongoing open dialogue under a pre-compliance review or the key taxpayer engagement approach and the ATO has concluded that the arrangement is low risk or that it has adequate information to make any necessary assessment, that transaction/arrangement should be excluded from the operation of the proposed DPT. The foregoing is on the basis that there has been no material change to the facts and circumstances.

Such an exclusion is necessary as the DPT in its proposed form could apply simply because the ATO disagrees with the transfer price adopted by a taxpayer. This is the case even where there is no recharacterisation (because the structure is not contrived), the company has disclosed all relevant information to the ATO and detailed transfer pricing documentation has been prepared to support the transfer price. To ensure the DPT is only utilised by the ATO to deal with taxpayers who transfer functions, assets or risks to offshore related parties using artificial or contrived arrangements to avoid Australian tax and who are uncooperative in their dealings with the ATO[18], it is important that ongoing disputes where full disclosure has already been made do not trigger a DPT assessment. This accords with the original intent of the DPT as canvassed in the DP, that being that it only applies to uncooperative taxpayers.

- CFC rules

Transactions that are subject to the CFC rules where full attribution is made should be excluded from the operation of the proposed DPT.

- Safe Harbours

Transactions that are covered by the following "safe harbours" should be excluded from the operation of the proposed DPT:

- 5% mark-up per OECD guidelines for low value service arrangements
- Current and future ATO transfer pricing documentation simplification options (such as low value loans)
- Current and future Country by Country local file reporting exclusions (for example, less than $2 million of related party dealings or 2% of related party transactions)
- Transactions for which the ATO has provided a letter of comfort
- Transactions where the quantum of debt falls within existing thin capitalisation limits (see further section 7).

12 The start date for the DPT should be prospective

As currently drafted, it is not clear if the DPT will apply from income years commencing on or after 1 July 2017 (paragraph 1.109 of the EM) or from 1 July 2017 (application date in the DPT Bill).

The generally accepted approach in Australia is for laws to take effect on a prospective basis and to not apply to transactions in place prior to the relevant announcement.

If the DPT applies to income years commencing on or after 1 July 2017, transactions that commenced on or before 1 July 2017 and straddle the operative date of the DPT may involve a dual assessment process, with normal assessment procedures applying for the period before 1 July 2017 and potentially both normal assessment procedures and DPT assessments after that date. The significant complications arising out of these types of scenarios should support the application of the DPT to transactions that commence on or after 1 July 2017 and to transactions that commenced before that date where the ATO has not commenced audit activity on the transaction type giving rise to the tax benefit or where assessments on that transaction type have not yet issued. This acts as a further incentive for transactions to be resolved under the substantive provisions such as Div. 815B and not the untested DPT provisions, without detracting from the intent of the DPT.

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Given Treasury's apparent understanding of our concerns regarding the potential application of the proposed DPT to taxpayers who are complying with the law, as well as the ATO's recent public comments around the strength of the current corporate tax law framework[19] we can only assume that our legitimate and well-founded concerns around the introduction of the proposed DPT in Australia are being overlooked for political reasons.

Reactionary politics and the changes that usually accompany it are often not reflective of the changes that are actually required. Australia already has very strong anti-avoidance and transfer pricing rules, both of which have been recently updated. Whilst the Government seems open to addressing perceptions that the corporate tax system is in need of further integrity measures, little attention is being paid to perceptions of Australia no longer being a place that is open for business relative to other jurisdictions.

We urge the Government to consider what a provision like the DPT means in terms of a small open economy reliant on foreign investment to drive growth. In this regard, due consideration must be given to the proposed DPT's actual application so that it does not render other parts of our already complex and stringent corporate tax system either redundant or even more difficult to apply.

Should you wish to discuss any aspect of this submission in further detail, please do not hesitate to contact Michelle de Niese or Peter Meehan.

We look forward to engaging constructively with both Treasury and the ATO on the issues raised above.

Michelle de Niese
Executive Director
Corporate Tax Association

Peter Meehan
Chief Executive Officer
Group of 100 Inc

[12] Divisions 815 A and B (transfer pricing rules) and Part IVA (general anti avoidance rules)
[13] See as examples paragraphs 1.2, 1.3, 1.4, 1.5 and 1.16 of the EM
[14] Paragraph 1.20 of the EM must be amended to reflect this point
[15] DP page 1
[16] See section 3 and Endnote 3
[17] IBID
[18] DP paragraph 12
[19] See Commissioner Chris Jordan's comments during ATO appearances at the Senate Inquiry into Tax Avoidance and aggressive Minimisation.

Corporate Tax Association

APPENDIX C

18 January 2017

Anne Vandenhurk
Department of Treasury
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Via e-mail –

Dear Anne

Treasury Laws Amendment (Combating Multinational Tax Avoidance) Bill 2017: increasing penalties for significant global entities

The Corporate Tax Association (CTA) welcomes the opportunity to comment on the "Treasury Laws Amendment (Combating Multinational Tax Avoidance) Bill 2017: increasing *penalties for significant global entities"* Exposure Draft (ED) and accompanying Explanatory Material (EM).

Whilst the CTA and its members fully acknowledge that the legislative intent to encourage significant global entities (SGE) to better comply with their tax obligations, particularly in the context of claims of multinational tax avoidance and evasion, it is our view the ED which increases failure to lodge (FTL) penalties by 100fold for all approved forms and doubles penalties for shortfalls where a SGE has taken a position that is not reasonably, is going beyond the Government's original intent with the measures as announced in the 2016-17 Budget Papers.

We have also attached as an appendix our letter of 3 June 2016 sent to Simon Duggan shortly after the May 2016 budget.

The Draft Bill goes beyond the Government's intent

1 The Draft Bill impacts Australian controlled groups with no foreign operations

On 3 May 2016, the Government announced the Tax integrity package – increasing administrative penalties for significant global entities where it states (emphasis added):

> The Government will increase administrative penalties imposed on companies with global revenue of $1 billion or more who fail to adhere to tax disclosure obligations. This measure will apply from 1 July 2017 and is estimated to have an unquantifiable gain to revenue over the forward estimates period.
>
> Penalties relating to the lodgement of tax documents to the Australian Taxation Office (ATO) will be increased by a factor of 100. This will raise the maximum penalty from $4,500 to $450,000, which will help to ensure that **multinational companies** do not opt out of their reporting obligations.
>
> Penalties relating to making statements to the ATO will be doubled, to increase the penalties imposed on **multinational companies** that are being reckless or careless in their tax affairs.
>
> This measure forms part of the Government's Tax Integrity Package, which will strengthen the integrity of Australia's tax system.

It is submitted the intent behind the Governments' proposal is to ensure **multinational companies** (those Australian groups that are controlled by non-residents and Australian groups that have foreign operations) should be subject to the increased administrative penalties and not SGEs that are controlled by Australian residents and only have Australian operations. The distinction is significant and important as the ED applies extremely widely, impacting Australian controlled groups operating solely in Australia where there is no potential loss of revenue from mispriced international related party transactions. For example, Australian listed trust groups, including listed Real Estate Investment Trusts, would be caught up in the proposed definition of SGE.

In our view, increasing FTL penalties by 100fold for such groups is going far beyond the intent with the FTL proposal as such entities have no exposure to misstatements of their tax obligations because of international dealings. It is recommended that SGEs that are controlled by Australian residents and have no foreign operations be excluded from the measure. The existing penalty regime operates as a sufficient deterrent for any non-compliance by domestic entities and should be left undisturbed by these changes.

2 The measure applies to any approved form

As the proposed measure is currently drafted, FTL penalties apply to any approved form that may be required to be lodged under a taxation law and not solely returns such as income tax returns, BAS, PRRT or country by country reports which may have a bearing on the calculation of a tax liability.

According to the summary of the measure outlined in Tax Fact Sheet 2 – "Ensuring Businesses Pay the Right Amount of Tax"[20] the proposed measure:

> " .. will increase the penalties for breach of tax reporting obligations for companies with global revenue of $1 billion or more. The Government will increase the maximum penalty for failing to lodge on time tax returns, business activity statements, country-by-country reports and similar tax documents – from $4,500 to $450,000…."

It is submitted that the intent of the provision is to apply to certain approved forms such as tax returns, BAS, income activity statements and country by country reports and not to <u>all</u> approved forms. In our view "similar tax documents" in the context of the proposed 100fold penalty increase should be limited to approved forms that are integral to the ATO in reviewing tax liabilities and should not apply to approved forms that are more in the nature of information. The latter group should remain subject to the existing FTL penalties. By way of example, as the ED currently operates, a SGE could be subject to a 100fold increase in FTL penalties for failing to notify the registrar of the Australian Business Register within 28 days of a change in an email or postal address under Paragraph 14(2)(b) of A New Tax System (Australian Business Number) Act 1999 which is the same penalty as applying to failing to lodge an income tax return or country by country report.21 Whilst it is recognised that lodging tax documents is an integral part of the tax system, to impose FTL penalties, albeit potentially subject to remission, on approved forms that do not go to the calculation of an ultimate tax liability, is unreasonable and not commensurate with the issue at hand or the Government's stated intent.

3 The doubling of penalties for positions that are not reasonably arguable appears *inconsistent with the Government's intent*

As mentioned in the EM at paragraph 1.5, the 2015 Act was amended to double the penalties that applied to SGEs for entering into tax avoidance and profit shifting schemes and was specifically not extended to other arrangements that created a tax shortfall, particularly where there was a reasonably arguable position.

As was mentioned in the 2015-16 Budget Paper No. 2:

> "The Government will double the maximum administrative penalties that can be applied by the Commissioner of Taxation to large companies that enter into tax avoidance and profit shifting schemes. The increased penalties, under Schedule 1 to the Taxation Administration Act 1953, will help to deter tax avoidance and will apply for income years commencing on or after 1 July 2015. This measure is estimated to have an unquantifiable gain to revenue over the forward estimates period.
>
> **Penalties will not change for taxpayers who have a 'reasonably arguable' tax position, as defined under Schedule 1.**" *(emphasis added).*[22]

Moreover in 2016-17 Budget Paper No. 2 it is stated that:

> "Penalties relating to making statements to the ATO will be doubled, to increase the penalties imposed on multinational companies that are being **reckless** or **careless** in their tax affairs." (emphasis added).

It is submitted the intent outlined in the 2016-17 Budget announcement is similar to that of the 2015 amendments, with the doubling of penalties only applying to cases where there is intentional, reckless or careless behaviour and not to circumstances where a SGE has taken a position which is ultimately viewed by the Commissioner as not reasonably arguable.

The Commissioner's discretion to remit penalties

Whilst recognising that section 388-55 of the Taxation Administration Act 1953 (TAA) allows the Commissioner to defer the time for the provision of an approved form, the working presumption in the current law is a FTL penalty is automatically imposed, and requires the Commissioner to exercise his discretion to remit such penalty.[23]

What this means in practice is ATO systems operate in such a way that penalties are automatically generated, thereby requiring work from both the taxpayer and the ATO to consider remission, even in the simplest of cases of late lodgment. Although a taxpayer may request a time to defer lodgment, practical issues will arise when lodgments are unknowingly late (such as a recently dormant entity, a nominee trustee, or a change of email address) or matters arising that are beyond the taxpayer's control. These circumstances stand in stark contrast to those where there is an intentional, reckless or careless late lodgment of an approved form.

Whilst it is recognised that the proposed subsection 286-80(4C) of the TAA does not limit the operation of section 298-20 of the TAA, and that amounts may be remitted, it is disappointing that the amount of the FTL penalty in itself will not be a relevant factor in the question of remission (see paragraph 1.27 of the EM). To put this in context, the FTL penalty for intentionally failing to lodge a tax return by one month would be $90,000 whereas the inadvertent failure to lodge a notification of a change in an email address by 2 months would be $180,000. In our view, given the 100fold increase in FTL penalties, along with the fact that they apply to all approved forms under the current ED, consideration of the amount of the penalty of itself should be a consideration in its remission. Although the ATO has indicated in its guidance that SGE's will receive a reminder for an earlier breach before they incur an FTL penalty, we also recommend that the ATO devote specific resources to deal with requests for remission where FTL penalties are imposed on SGEs under the proposed provisions.

Conclusion

When formulating changes to the tax law to combat tax avoidance or to discourage non-compliance, consideration must be given to the vast majority of large taxpayers who do comply with the law, who do engage constructively with the ATO and do pay the appropriate amount of tax. Measures aimed at those taxpayers who fall outside these parameters should not encroach on those that operate within them.

Although we support the Government's proposed policy of discouraging blatant breaches of tax reporting obligations, the sheer breadth of the proposed changes to the FTL and penalty provisions contained in the ED go beyond penalising those few SGEs that engage in such activity. Rather, the proposed amendments will effectively capture all SGEs, regardless of their lodgment history, type of approved form and whether they have taken reasonable care. In our view this outcome is contrary to the Government's stated intent.

It is also understood that these rules were designed specifically to capture large multinationals. A large multinational has a different tax profile than that of an Australian domestic enterprise, whether structured as a corporation or a trust. As a matter of public policy, multinationals should not be grouped with wholly Australian entities (even if they are SGEs) with no international dealings or transfer pricing tax risk. In this regard, the existing penalty regime should be left undisturbed for wholly Australian SGEs.

The CTA would welcome the opportunity to discuss the above with you to ensure the proposed amendments to the penalties regime are aligned with the Government's intent and that those that operate within the boundaries of the existing law are not inadvertently affected by the proposed changes.

Should you have any questions, please do not hesitate to contact either Paul Suppree or me.

Regards

Michelle De Niese
Executive Director

[20] See: http://budget.gov.au/2016-17/content/glossies/tax_super/downloads/FS-Tax/02-TFS-Ensuring_businesses_pay_their_fair_share.pdf

[21] A complete listing of current approved forms can be found at: https://www.ato.gov.au/Tax-professionals/TP/Consolidated-list-of-approved-forms-by-tax-topic/

[22] See: http://www.budget.gov.au/2015-16/content/bp2/html/bp2_revenue-07.htm

[23] The Commissioner has issued a guidance on "failure to lodge on time" penalties and the exercise of his discretion which can be found at: https://www.ato.gov.au/business/business-activity-statements-(bas)/in-detail/lodgment-and-payment/failure-to-lodge-on-time-(ftl)-penalty-faqs/. Practice Statement PSLA 2011/15 provides more details on the specifics of the exercise of the Commissioner's discretion. See http://law.ato.gov.au/atolaw/view.htm?docid=PSR/PS201115/NAT/ATO/00001

Corporate Tax Association

APPENDIX D

Recent Australian Tax Integrity and Tax Disclosure Measures

	Measure	Effective Date	Summary of Change
1	General Anti-avoidance	Schemes entered into after 16 November 2012	Strengthening of the definition of tax benefit
2	Multinational anti-avoidance law	From 1 January 2016	Prevent the artificial avoidance of permanent establishments
3	Thin capitalisation	1 July 2014	Reduction in safe harbour debt limits from 75% to 60% for Non Banks and from 95% to 90% for Banks of Australian Assets.
4	Transfer Pricing	For years ending 30 June 2014	Substantial changes to modernise Australian rules to accord with contemporary OECD standards. Requirement for contemporaneous documentation to support positions taken otherwise significant penalties imposed.
5	Country by Country Reporting	For tax years commencing on or after 1 January 2016	Requirement to file country by country reports, including master and local files with the ATO in accordance with OECD requirements
6	Tax Transparency Code	May 2016	Implementation of tax transparency code for large corporations,
7	Public tax disclosures	From the 2014 income tax year	ATO to annually publish tax data for publicly listed and foreign taxpayers with over $100m turnover of total income, taxable income and tax paid (including PRRT)
8	Filing of general purpose financial statements	For tax years commencing on or after 1 January 2016	Requirement to lodge general purposes financial statements with the ATO
9	Tax Exchange of Information Agreements	Various	TEIAs to enable ATO access to information from 36 non treaty country tax administrators, including countries such as Cayman Islands, Luxembourg & Bermuda,
10	Reportable tax positions	From the 2014 income tax year	Taxpayers to disclose to the ATO tax positions taken that are not reasonably arguable
11	Revised International Dealings Schedule	From the 2012 income tax year	Modernisation of related party tax disclosures to the ATO, including details of all related party transactions
12	Anti–hybrid rules	1 January 2018 or six months after the hybrid mismatch legislation receives Royal Assent.	Adoption of OECD standards to ensure no double non taxation or double deductions for certain hybrid instruments and structures

13	Updated OECD transfer pricing rules	Proposed to apply as from 1 July 2016	Australia to adopt revised OECD BEPS transfer pricing guidance into Australia's tax laws
14	Diverted Profits Tax	From 1 July 2017	40% tax on certain transactions with lower tax jurisdictions to ensure tax is paid in where activities of economic substance reside.
15	100-fold increase in late lodgement penalties	From 1 July 2017	A 100-fold increase in penalties for late lodgement of approved forms with the ATO (i.e. $90,000 per month for any approved form).
16	Doubling of penalties for false and misleading statements	From 1 July 2017	A 100% increase in penalties for false or misleading statements.
17	Revised reportable tax positions	For income years commencing after 1 July 2016	Revised filing requirements for certain transactions that are subject to certain ATO Tax Alerts
18	Doubling of penalties for international tax schemes	From 1 July 2015	100% penalty applying to significant global entities for entering into tax avoidance and profit shifting schemes with the dominant purpose of creating a tax benefit. 50% penalty if no dominant purpose.
19	Adoption of the OECD multilateral instrument for all tax treaties	Potentially take effect in Australia from 1 January 2019. Signing on 1 July 2017.	Adoption of new BEPS standard for existing treaties including revised PE test, principal purpose test for treaty shopping and mandatory arbitration.