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13 October 2015

Inquiry into Tax Laws Amendment (Combating Multinational Tax Avoidance) Bill 2015: EY Submission

Dear Dr Dermody

We refer to your email of 22 September 2015 to Glenn Williams inviting EY to make a submission to the Senate Economics Legislation Committee's Inquiry into Tax Laws Amendment (Combating Multinational Tax Avoidance) Bill ("CMTA Bill").

We thank you for providing us with the opportunity to make a submission to the Committee in respect of its Inquiry into the CMTA Bill.

EY has previously been involved in consultation with Australian Taxation Office ("ATO") and Treasury officials and provided submissions[1] on the Exposure Draft of the Tax Laws Amendment (Tax Integrity Multi-national Anti-avoidance Law) Bill 2015 ("Superseded MAAL Bill").

We note your request for submissions to identify concerns with the CMTA Bill as drafted and indicate potential amendments that address those concerns.

Summary

In summary, our submission points are that:

- it is important that an appropriately defined 'no or low corporate tax' condition is reinstated to the provisions of the CMTA Bill; and
- consideration should be given to a later commencement date for Schedule 2 of the CMTA Bill

Submission

By way of background to our submission, we consider it important to provide the following context.

1. Inter-action between CMTA Bill and OECD Action Plan on Base Erosion and Profit Shifting (BEPS)

[1] The EY submission dated 9 June 2015 focused on policy issues raised by the Superseded MAAL Bill. EY's joint submission with the Corporate Tax Association dated 15 June 2015 focused on practical and technical issues relating to the drafting and scope of the Superseded MAAL Bill. These submissions can be accessed at: http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2015/Multinational-tax-avoidance

On 5 October 2015, the OECD released its Final Reports for the BEPS project.[2] The overall aim of the BEPS Project and its proposed measures is *to close gaps in international tax rules that allow multinational enterprises to legally but artificially shift profits to low or no-tax jurisdictions.*[3]

The 15 Final Reports relate to the 15 Action Items of the BEPS Action Plan.[4]

Paragraph 3.2 of Chapter 3 of the Explanatory Memorandum (EM) to the CMTA Bill indicates that the multinational anti-avoidance law (MAAL) introduced by Schedule 2 to the CMTA Bill is "designed to counter the erosion of the Australian tax base by multinational entities using artificial or contrived arrangements to avoid the attribution of business profits to Australia through a taxable presence in Australia".[5]

More specifically, MAAL targets those multinationals that:

- *avoid a taxable presence by undertaking significant work in Australian in direct connection to Australian sales but booking their revenue offshore; and*
- *have a principal purpose of avoiding tax in Australia or reducing their foreign tax liability.*[6]

The legislative means by which the multinational anti-avoidance law achieves its aim is by amendment to the existing general anti-avoidance rule ("GAAR") contained in Part IVA of the Income Tax Assessment Act 1936 (ITAA 1936).

Certain Actions of the BEPS Action Plan deal with the same perceived problems to which MAAL, contained in the CMTA Bill, is directed. Thus the Final Report in relation to Action 7, *Preventing the Artificial Avoidance of Permanent Establishment*, outlines strategies that have been commonly adopted by multinationals in order to circumvent the existence of a permanent establishment (PE) and suggests changes that can be made to the definition of PE in Article 5 of the OECD Model Tax Convention.

The Final Report on Action 7 indicates:[7]

> Together with the changes to tax treaties proposed in the Report on Action 6 (*Preventing the Granting of Treaty Benefits in Inappropriate Circumstances*, OECD, 2015a), the changes recommended in this report will restore taxation in a number of cases where cross-border income would otherwise go untaxed or would be taxed at very low rates as result of the provisions of tax treaties. Taken together, these tax treaty changes will enable countries to address BEPS concerns resulting from tax treaties, which was a key focus of the work mandated by the BEPS Action Plan.

It is also noted that Action 15, *Developing a Multilateral Instrument to Modify Bilateral Tax Treaties,* has a goal of streamlining the implementation of the tax treaty related BEPS measures by the development of a multilateral instrument to enable countries to implement those measures and amend bilateral tax treaties.[8]

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[2] http://www.oecd.org/ctp/beps-2015-final-reports.htm. Executive summaries of the final reports can be accessed at: http://www.oecd.org/ctp/beps-reports-2015-executive-summaries.pdf
[3] See the OECD *Policy Brief*, October 2015, BEPS Update No. 3, http://www.oecd.org/ctp/policy-brief-beps-2015.pdf
[4] For a history, timeline and list of outputs in relation to the 15 Actions, see http://www.oecd.org/ctp/beps-actions.htm
[5] At 23.
[6] See par 3.4 of the EM at 23.
[7] OECD (2015), *Preventing the Artificial Avoidance of Permanent Establishment Status, Action 7 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, at 9. Accessed at *http://dx.doi.org/10.1787/9789264241220-en.*
[8] OECD (2015), *Developing a Multilateral Instrument to Modify Bilateral Tax Treaties, Action 15 -2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, at 9. Accessed at *http://dx.doi.org/10.1787/9789264241688-en*

On 6 October 2015, the Treasurer, The Hon Scott Morrison MP, issued a media release[9] in which he indicated that the "release of the OECD's Final Report on the Base Erosion and Profit Shifting (BEPS) Action Plan shows that Australia is firmly on the right track when it comes to ensuring multinationals pay their fair share of tax." The media release indicated that the "strong measures" that the Government had taken are "entirely consistent with the final OECD recommendations" and "attack the heart of the multinational tax avoidance problem...".

An attachment to the media release indicates that the MAAL contained in the CMTA Bill is the action that Australia is taking in relation to BEPS Action 7.

There is clearly an overlap between the unilateral action that Australia is taking in respect of the introduction of MAAL by the CMTA Bill and the work being undertaken, which is nearing completion, in respect of certain of the BEPS Action Items, especially work in respect of the development of a multinational instrument under Action 15.

In our view, there is a significant risk that the proposed MAAL will undermine confidence in the integrity of Australia's double tax agreements ("DTAs") and create uncertainty for foreign investment in Australia. In this regard, the MAAL law will operate despite an inconsistency with a DTA since the GAAR overrides the terms of a DTA.[10] It is in this context that we make the following suggestions in respect of the CMTA Bill.

2. Deletion of 'no or low corporate tax' condition from CMTA Bill

The Superseded MAAL Bill contained a provision[11] that was a condition to be satisfied in determining whether a relevant scheme existed for the purposes of the proposed law. That provision required that the relevant non-resident be "connected with a no or low corporate tax jurisdiction (see subsections (8) to (11))." In our submission relating to that provision,[12] and in other submissions made in relation to the Superseded MAAL Bill,[13] there was an issue as to the meaning of the 'no or low corporate tax' requirement. However, instead of the CTMA Bill providing definitional clarification as to its meaning, the response of the legislative draftsperson has been to delete the 'no or low corporate tax' condition from section 177DA of the CMTA Bill.

We understand that the inclusion of a 'no or low corporate tax condition' was a specific design feature of the proposed measure to ensure that the measure would only operate in circumstances in which profits that may otherwise have arisen in Australia arise in a no or low tax jurisdiction. Put another way, the mischief to which the MAAL provisions of the CMTA Bill was/is designed to deal with is limited to situations in which income that may otherwise have been taxable in Australia is now arising in a no or low tax jurisdiction. This has been referred to as 'stateless income'.

The submissions in relation to the 'no or low corporate tax' condition did not advocate its removal. Rather, they recommended clarification in a definitional sense. We recommend that the condition is reinstated and appropriately defined. To assist, and by way of example, 'no or low corporate tax' could be defined by reference to an appropriate income tax rate. Alternatively (or possibly in addition), it could

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[9] http://sjm.ministers.treasury.gov.au/media-release/003-2015/
[10] Section 4(2) *International Tax Agreements Act 1953*
[11] Section 177DA(1)(e)
[12] See the EY Submission of 9 June 2015 and the EY and CTA Submission of 15 June 2015, referred to in Note 1 above.
[13] See http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2015/Multinational-tax-avoidance

be defined to exclude income arising to a tax resident of a country with which Australia has concluded a DTA if the income is subject to the normal rate of corporate income tax in that country. The latter alternative has the advantage of removing much of the risk of undermining the integrity of Australia's DTAs and acknowledges that Australia does not generally enter into a DTA with no or low tax jurisdictions. By way of example, given the stated purpose of the MAAL, its potential application, as a consequence of removing the 'no or low corporate tax' condition, to a taxpayer resident in the United States and subject to US corporate income tax demonstrates that the removal of the no or low corporate tax condition introduces inappropriate uncertainty.

In our view, our recommended amendments ensure that the MAAL achieves its stated purpose but does not introduce significant uncertainty or override DTA outcomes in situations where little or no risk of "stateless income" arises.

3. Commencement date

Paragraph 7 of Schedule 2 to the CMTA Bill indicates that MAAL, contained in Schedule 2, will "apply on or after 1 January 2016 in connection with a scheme, whether or not the scheme was entered, into, or was commenced to be carried out, before that day."

Given the CTMA Bill will not be passed until nearer to 1 January 2016, we are of the view that the commencement date of the proposed amendments contained in the CMTA Bill of 1 January 2016 should be amended with a later commencement date. In our view, it is not feasible to have a commencement date that is now less than 3 months away. In our view the commencement date should be no earlier than years of income commencing on or after 1 July 2016.

For taxpayers with existing structures that may be at risk under the proposed provisions, we understand that the Government and the ATO anticipate that their response to MAAL will be a restructuring of their inter-group arrangements to ensure that they do not fall within MAAL. To the extent that a restructure is required, taxpayers will need time to consider the most appropriate way in which to effect a restructure and to implement the restructure, including obtaining all necessary approvals.

We have a number of other less important matters on which we have made a submission. These are set out in the attached Appendix A.

Again, thank you for the opportunity to make this submission. If you have any queries please contact Daryn Moore, Partner, Oceania Leader- International Tax Services [daryn.moore@au.ey.com – 02 9248 5538].

Yours faithfully

Ernst & Young

Attachment

Appendix A

1. Section 177DA and statutory interpretation

Although proposed section 177DA is part of Australia's GAAR, that is it is a part of a general anti-avoidance provisions, it is nevertheless a targeted measure and we are concerned that in seeking to interpret its provisions (whether by taxpayers, the ATO, or Tribunals or Courts) many of the key terms and expressions used are undefined and, generally, the language is cast in wide terms which lack clarity and admit ambiguity.[14] In our view these concerns cannot be dismissed simply on the basis that the EM sets out in detail the understanding and purpose of many of the provisions and supplies the detail by which the meaning of the provisions is to be determined. In construing legislation it is necessary to consider context and purpose[15] and it is appropriate to have regard to the various contextual considerations and extrinsic material that includes explanatory memoranda. However, it is now clear that as a matter of statutory construction regard to the text or statutory words actually used in the relevant legislative provisions are also required to be considered at the outset.[16]

In *Alcan (NT) Alumina Pty Ltd v Commissioner of Territory Revenue (Northern Territory),*[17] Hayne, Heydon, Crennan and Kiefel JJ said[18] (citations omitted):

> This Court has stated on many occasions that the task of statutory construction must begin with a consideration of the text itself. Historical considerations and extrinsic materials cannot be relied on to displace the clear meaning of the text. The language which has actually been employed in the text of legislation is the surest guide to legislative intention. The meaning of the text may require consideration of the context, which includes the general purpose and policy of a provision, in particular the mischief it is seeking to remedy.

In *Saeed v Minister for Immigration and Citizenship*[19]; French CJ, Gummow, Hayne, Crennan and Kiefel JJ stated[20] (citations omitted):

> As Gummow J observed in *Wik Peoples v Queensland*, it is necessary to keep in mind that when it is said the legislative "intention" is to be ascertained, "what is involved is the 'intention *manifested*' by the legislation". Statements as to legislative intention made in explanatory memoranda or by Ministers, however clear or emphatic, cannot overcome the need to carefully consider the words of the statute to ascertain its meaning.

In *Certain Lloyd's Underwriters v Cross,*[21] French CJ and Hayne J elaborated upon the statements in *Alcan*[22] (citations omitted):

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[14] See the discussion under the heading 'Miscellaneous drafting issues', below, for examples of key words and phrases used in section 177DA whose meaning is, in our view, undefined or unclear.
[15] See, for example *Alcan (NT) Alumina Pty Ltd v Commissioner of Territory Revenue (Northern Territory)* [2009] HCA 41 at [47]; *Minister for Immigration and Border Protection v Han* [2015] FCAFC 79 at [6]; *Cameron Brae Pty Ltd* v *Commissioner of Taxation* [2007] FCAFC 135 at [3]; *CIC Insurance Ltd v Bankstown Football Club Ltd* [1997] HCA 2; *Braverus Maritime Inc v Port Kembla Coal Terminal Ltd* [2005] FCAFC 256 at 36; *Project Blue Sky Inc v Australian Broadcasting Authority* [1998] HCA 28 at [69-70]; *IRG Technical Services Pty Ltd v Deputy Commissioner of Taxation* [2007] FCA 1867 at [21]; *Certain Lloyd's Underwriters v Cross* [2012] HCA 56 at [24]-[26].
[16] See, for example, *Cameron Brae Pty Ltd* v *Commissioner of Taxation* [2007] FCAFC 135 at [3]; *CIC Insurance Ltd v Bankstown Football Club Ltd* [1997] HCA 2; *Braverus Maritime Inc v Port Kembla Coal Terminal Ltd* [2005] FCAFC 256 at 36; *Project Blue Sky Inc v Australian Broadcasting Authority* [1998] HCA 28 at [69-70]; *IRG Technical Services Pty Ltd v Deputy Commissioner of Taxation* [2007] FCA 1867 at [21]; *Certain Lloyd's Underwriters v Cross* [2012] HCA 56 at [24]-[26].
[17] [2009] HCA 41.
[18] Ibid at [47].
[19] [2010] HCA 23.
[20] Ibid at [31].
[21] [2012] HCA 56.

24. The context and purpose of a provision are important to its proper construction because, as the plurality said in *Project Blue Sky Inc v Australian Broadcasting Authority*, "[t]he primary object of statutory construction is to construe the relevant provision so that it is consistent with the language and purpose of *all* the provisions of the statute" (emphasis added). That is, statutory construction requires deciding what is the legal meaning of the relevant provision "by reference to the language of the instrument viewed as a whole", and "the context, the general purpose and policy of a provision and its consistency and fairness are surer guides to its meaning than the logic with which it is constructed".

25. Determination of the purpose of a statute or of particular provisions in a statute may be based upon an express statement of purpose in the statute itself, inference from its text and structure and, where appropriate, reference to extrinsic materials. The purpose of a statute resides in its text and structure. Determination of a statutory purpose neither permits nor requires some search for what those who promoted or passed the legislation may have had in mind when it was enacted. It is important in this respect, as in others, to recognise that to speak of legislative "intention" is to use a metaphor. Use of that metaphor must not mislead. "[T]he duty of a court is to give the words of a statutory provision the meaning that the legislature *is taken to have intended* them to have" (emphasis added)

In our view, it is not clear what the approach of a Court will be in construing section 177DA. It may be that a Court will have little regard to the EM (other than it providing the history and context for the provision) since, in its view, the text provides a clear meaning and that "[h]istorical considerations and extrinsic material cannot be relied on to displace the clear meaning of the text".[23] In our view, therefore, it is vitally important that the provisions, from the start, are drafted with as much clarity as possible and that key terms and phrases are clearly defined. It is far preferable that the meaning of the proposed section 177DA is reasonably well understood and settled at the commencement date rather than waiting for a Court(s) to provide guidance. The meaning of Part IVA has emerged through numerous Court decisions over 30 years, a similar timeframe in respect of the meaning of section 177DA should be avoided by commencing with clearly defined words and expressions and by using unambiguous language.

2. Miscellaneous drafting issues

2.1 Section 177DA(1)(a)(i) – a foreign entity makes a *supply* to an *Australian customer* of the foreign entity

The meaning of *supply* is, pursuant to section 177A(1), the meaning given by section 9-10 of the *A New Tax System (Goods and Services Tax) Act 1999* (Cth) ("GST Act"). We are not of the view that "supply" should be defined by reference to its meaning in the GST Act. First, it is impossible to know whether changes that are made to that definition in the GST Act in the future are appropriate to its meaning in the context of the MAAL. Secondly, the concept of "supply" in the GST Act is a key term since a GST liability will not, save for importation, arise unless there is a "supply" for the purposes of the GST Act. Accordingly, the definition of "supply" for the purposes of GST is drafted in very broad terms. We do not believe that such a wide definition is relevant for the purposes of MAAL.

Accordingly, we are of the view that an appropriate definition should be contained in section 177A(1) and its meaning should not be incorporated by reference to its meaning in the GST Act.

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[22] Ibid at [24]-[26].
[23] *Alcan (NT) Alumina Pty Ltd v Commissioner of Territory Revenue (Northern Territory)* [23] [2009] HCA 41 at 47.

The meaning of "Australian customer" is contained in section 177A(1). Since the phrase "Australian customer" is an exhaustively defined term in section 177A(1), satisfied by the existence of entities as described, it is not necessary to give any meaning to the word "customer". That is, the existence of an "Australian customer" depends on whether there is an entity of the kind provided for in the definition. In our view a word such as "customer" should not be used since, prima facie, it seems to require consideration of whether an entity is in fact a customer. Alternatively, there should be an asterisk after "customer" to indicate that it is a defined term.

2.2 Section 177DA(1)(a)(ii) – activities are undertaken in Australian *directly in connection with* the supply

Section 177DA(1)(a)(ii) requires that the scheme must have activities that are undertaken in Australia "directly in connection with" the supply made by the foreign entity. The EM, at paragraph 3.39, indicates that the extent of the direct connection "will depend on the facts and circumstances of the particular scheme but it is intended to be broad".

.Although we welcome the use of "directly" to qualify "in connection with", the phrase "in connection with" is itself very broad and apart from requiring some link between the activities and the supply, it is by no means clear to the extent of the relationship that is required or ought to be required.

The activities of global business are necessarily interrelated so that at some level a connection could almost always be found between a supply and activities in Australia where the entity has an Australian presence.

In our view further clarity is required in respect of the intended link between the activities and the supply

2.3 Section177DA(1)(a)(iii) - …who, is an associate of or is *commercially dependent* on the foreign entity

Section 177DA(1)(a)(iii) requires that the Australian entity that undertakes the activities is an associate of the foreign entity or is "commercially dependent" on the foreign entity. The EM, at paragraph 3.44, indicates the expression "commercially dependent" is not defined and takes its ordinary meaning. We are of the view that the expression is a key term and gateway into the provisions and its meaning should be given through legislative means.[24]

2.4 Section 177DA(1)(b) – relevant purpose

Section 177DA(1)(b) provides as follows:

> (b) it would be concluded (having regard to the matters in subsection (2)) that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme did so *for a principal purpose of, or for more than one principal purpose that includes a purpose of:*
>
> > (i) enabling a taxpayer (a ***relevant taxpayer***) to obtain a tax benefit, or both to obtain a tax benefit and to reduce one or more of the relevant taxpayer's liabilities to tax under a foreign law, in connection with the scheme; or

[24] We note that the 2015 Final Report for Action 7, *Preventing the Artificial Avoidance of Permanent Establishment Status*, recommends amending paragraphs 5 and 6 of Article 5 in relation to artificial avoidance of PE status through commissionaire arrangements and similar strategies. It introduces a concept of a person acting exclusively or almost exclusively acting for another to which it is "closely related": see pages 15-27, esp at 16-17 and 26-27.

> (ii) enabling the relevant taxpayer and another taxpayer (or other taxpayers) each to obtain a tax benefit, or both to obtain a tax benefit and to reduce one or more of their liabilities to tax under a foreign law, in connection with the scheme; (emphasis added)

The EM, at paragraph 3.57, indicates that under MAAL the purpose test is expressed in terms of 'principal purpose or more than one principal purpose' rather than the 'sole or dominant purpose' as required under the current section 177D(1) of the GAAR. It seems that the intention is that there must be a principal purpose of enabling a taxpayer to obtain a tax benefit (ie, an Australian tax benefit within section 177C of the GAAR), or to obtain both a tax benefit and to reduce a foreign tax liability (as defined). Thus 3.61 of the EM indicates:

> Under this measure, it is sufficient that there was a purpose of obtaining the tax benefit and that this purpose, combined with another purpose of reducing liability to tax under a foreign law, amounted to the principal purpose or one of the principal purposes. This means that a principal purpose of reducing a foreign tax liability that included a purpose of obtaining a tax benefit (as per section 177C) would satisfy the purpose test. ***[Schedule 2, item 4, paragraph 177DA(1)(b)]***

In our view the drafting of section 177DA(1)(b) does not unambiguously achieve the above result. The words *or for more than one principal purpose that includes a purpose of* are, in our view, unclear. Presumably the intention is that, where there is more than one principal purpose, one of those principal purposes must satisfy either of paragraph (i) or (ii). However, at present the provision simply refers to "purpose". Therefore, in our view, the word "principal" should be inserted such that the provision reads *or for more than one principal purpose that includes a* ***principal*** *purpose of* (insertion in bold).

* * * * *