CORPORATE TAX
ASSOCIATION
of Australia Incorporated

15th October 2015

Committee Secretary
Senate Economics Legislation Committee
PO Box 6100
Parliament House
Canberra ACT 2600

Dear Dr Dermody

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

The Corporate Tax Association (CTA) welcomes the opportunity to provide a submission on the exposure draft and explanatory materials (EM) to the *Tax Laws Amendment (Combating Multinational Tax Avoidance) Bill 2015.*

We note that given the relatively short timeline for the inquiry, the committee is seeking submissions that identify concerns with the Bill as drafted and indicate potential amendments that could be made to address these concerns. Our response focusses on two main components of the Bill namely:

- the provisions which amend Part IVA (Schedule 2 to the Bill), and
- the introduction of Country by Country reporting (Schedule 4 to the Bill).

Part IVA amendments

Ensure the Part IVA amendments do not create a compliance nightmare for Australian based multinationals

As you are no doubt aware, the current draft Bill in relation to the Part IVA amendments varies dramatically from the previous draft which was consulted on prior to the Bill being introduced into Parliament. The current Bill significantly increases the scope of the multinational anti-avoidance law (MAAL) from the previous draft with the result being a significantly larger number of taxpayers needing to work through the provisions to ensure they do not apply. Although

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we understand the political optics at play here, big ticket changes such as the MAAL deserve proper consultation to ensure the legislation meets its policy intentions. In the absence of such consultation business is left to interpret widely drawn legislation and rely heavily on yet to be drafted ATO guidance, with the accompanying uncertainty denting perceptions that Australia is a good place in which to do business.

Although discussions are currently underway with the ATO on the provision of written guidance, significant uncertainty still exists. We note in particular at paragraph 6.65 of the EM it indicates that "the proposal should not have any direct impact on Australian owned multinational companies or purely domestic companies because they already have a taxable presence in Australia. These entities will continue to be subject to the GAAR." If this is the Government's intent, it is not adequately reflected in the operation of the proposed provisions. For example, an Australian headquartered group could have foreign subsidiaries that may be dealing directly with Australian customers and be caught by the provisions, or at least have to work through them to ensure they do not apply.

It is worth noting that if such instances do exist, it is likely other tax integrity rules such as the CFC rules may subject such profits to tax as they accrue or if such profits are not subject to the CFC rules, such profits would be taxed when they eventually come home to Australia and are distributed to shareholders as an unfranked dividend. In our view, if the intent of the rules is not to impact Australian based multinationals then a carve-out for Australian headquartered groups could be introduced to ensure sec 177DA does not apply.

<u>Ensure that arrangements covered by certain group structures are excluded from the rules.</u>

It is a design feature of the MAAL that companies with a taxable presence in Australia that are buying from a related party are not subject to the rules. As mentioned in paragraph 3.24 of the EM, the rules are designed:

> "...to target schemes that involve supplies to arm's length Australian customers and exclude supplies between the foreign entity and members of its global group (that is, intra-group supplies)."

The MAAL is not seen as being required in such cases as such supplies are subject to normal transfer pricing rules and the potential operation of the general anti-avoidance rule in Part IVA. Thus a local Australian entity buying goods from a related party in the same group is carved out of the rules as existing transfer pricing rules ensure the right amount of tax is paid locally as the Australian purchaser is buying at an arm's length price and is selling to an unrelated third party and there is no avoidance of a permanent establishment (PE).

However, as the rules are drafted, where the overseas affiliate is not part of the same global accounting group, because for example they have 49% common ownership not 50% or more, the MAAL rules can apply, even though the supplies are intra-group and subject to transfer pricing rules and there is no avoidance of a PE.

It is submitted that, to avoid the rules extending beyond their intended scope, the definition of "Australian customer" in sec 177A(1) is amended such that the exclusion in paragraph (b) is extended to exclude entities in Australia which are subject to the Australia's transfer pricing provisions in relation to their supply arrangements with the relevant foreign entity.

This should ensure that the transfer pricing rules and general anti avoidance rules continue to operate as intended in such cases.

Consider a sunset clause in the provisions as and when treaty changes to the definition of PE take effect.

One issue raised in our submission on the original draft Bill was that the proposed changes to Part IVA should be revisited, or subject to a sunset provision, as and when the recommendations to the changes to the definition of PE agreed to as part of the OECD BEPS Action plan (Action 7) are incorporated into Australia's treaty network. As the Committee may be aware, the OECD has been grappling with the artificial avoidance of PE status from a global perspective and has recommended changes to the Model Treaty (and commentary) and also introduced a principle purpose test as part of the BEPS outcomes (BEPS Action 6). The effect of these changes, when incorporated into Australia's treaty network, will be to effectively make the proposed amendments to Part IVA redundant. We note that the OECD Head of Tax Policy, Pascal Saint-Amans, effectively said as much when he introduced the suite of BEPS Action items on the 5th October 2015. In an article published in the Australian Financial Review on the 6th October he is quoted as saying:

> "BEPS is more consistent with what's been agreed internationally, than what Australia currently has. What you do if you have existing domestic legislation is a matter for your government, but you might find that such domestic measures might not be useful anymore."

In our view, it is important to seriously consider, once Australia's treaties are amended, that the proposed sec 177DA be reviewed, and possibly repealed. We note the changes to treaties, as and when they are implemented, have wider reach than the current proposed changes, as they apply to all taxpayers, not just those that meet the $1 billion global turnover threshold. More importantly the tests in treaties have global acceptance. We think it sends the wrong message, that even though the global standards have changed, the spectre of Australia continuing to apply what is effectively a stop gap rule over and above a globally agreed standard, remains on the books.

Ensure that appropriate costs and foreign taxes are considered when making compensatory adjustments

We note that where the MAAL rules apply, the tax benefit to which the provisions apply is prima facie the gross amount of assessable income that is avoided, but the Commissioner may make compensatory adjustments to reduce that tax benefit where is it fair and reasonable to do so. The intent here is to ensure, in appropriate cases, that only the business profits (that is the gross revenue less appropriate tax deductions) attributed to the deemed PE are subject to Australian tax. Our concern is the mechanics of Part IVA rely on the Commissioner determining what a fair and reasonable adjustment is without necessarily directing the Commissioner to the types of adjustments he should consider when exercising his discretion.

Although there are statements in the EM that the Commissioner should apply his compensatory adjustment powers in this way, and whilst also recognising the exercise of this power is subject to review, we submit that the provisions in sec 177F of the *Income Tax Assessment Act 1936* should be amended to ensure for the purposes of sec 177DA, the Commissioner must consider the amount of business profit and any foreign taxes paid on that profit when exercising his compensatory adjustment power.

This amendment would help ensure the deemed PE is in the position it would have been had it been an actual PE paying the appropriate level of primary tax and ensures, in appropriate cases, there is no double tax on that profit. In our view, the imposition of penalties is the appropriate means to deal with issues of culpability, not via the denial of notional deductions or actual tax paid which effectively act as a disguised form of penalty. We note the UK diverted profits tax works on this basis.

Country by Country Reporting - Ensure local file requirements are identical to current transfer pricing documentation requirements

As mentioned in the EM, the proposed amendments in Schedule 4 are aimed at implementing Action 13 of the G20 and OECD BEPS Action Plan which recognises that enhancing transparency for tax administrations provides them with adequate information to conduct transfer pricing risk assessments, which is an essential part of tackling base erosion and profit shifting. [1]

In essence the proposed rules require impacted groups to prepare:

- a country by country (CbC) report;
- a master file; and
- a local file(s).

As you may be aware, existing transfer pricing documentation requirements under sec 284-255 of Sch. 1 of the *Taxation Administration Act 1953* currently provide granular detail to assist the Commissioner (ATO) in its compliance activities and are essentially equivalent to local files for the purposes of the OECD guidelines. If a taxpayer does not document its position and there is a transfer pricing benefit, significant penalties can apply. In addition, all taxpayers with over $2 million in related party transactions currently prepare a 16 page International Dealing Schedule which outlines in detail all types of related party dealings, including those with specified (low taxed) countries. Moreover large taxpayers are subject to real time compliance activities (such as the pre-compliance review process) where issues such as transfer pricing are discussed each year between the taxpayer and the ATO. Our major concern with Schedule 4 is, despite the reality of the current compliance environment and the open and transparent relationship the vast majority of large taxpayers have with the ATO, it creates an obligation for all groups to prepare additional statements and documentation, depending on whether the ATO may by administrative process, reduce statement requirements should it feel appropriate to do so.

In our view, the Bill should be amended such that for the purposes of meeting the requirements of CbC reporting, the current transfer pricing requirements under sec 284-255 of Sch. 1 of the *Tax Administration Act 1953* are considered to be the local files for the purposes of the statements that are required under the proposed paragraph 815-355(3)(b).

[1] See page 9 OECD (2014), Guidance on Transfer Pricing Documentation and Country-by-Country Reporting.

This ensures impacted companies continue to produce CbC reports and master files but there is not unnecessary duplication and added compliance costs associated with producing local files and current transfer pricing documentation which are essentially the same thing. Should the ATO consider it requires additional information not in current transfer pricing documentation requirements it can always ask for that information at that time rather than requiring all impacted taxpayers to produce the documentation annually. We make the point that the OECD CbC guidelines make it clear that the documentation requirements are used as a tax authority risk assessment tool, not a detailed blow by blow account of every international related party transaction. In our view to create a rule requiring all impacted taxpayers to produce additional reports on an annual basis for effectively all related party transactions is disproportionate to the risk that current documentation files required under sec 284-255, supplemented by the ability for the Commissioner to seek further information, potentially do not address.

Thank you again for the opportunity to make a submission. Should you have any questions in relation to the above, please feel free to contact me on

Yours sincerely

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