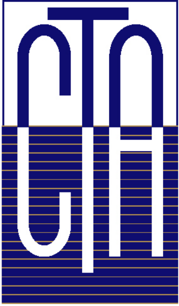
SUBMISSION 7



CORPORATE TAX ASSOCIATION
of Australia Incorporated

22 February 2013

The House Economics Committee
Parliament House
Canberra ACT 2600

By e-mail economics.reps@aph.gov.au

Submission on
Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013

The Corporate Tax Association (CTA), which represents the taxation interests of about 120 of Australia's largest companies, welcomes this opportunity to offer some comments on the Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013 (the Bill) as referred to the House Economics Committee on Economics on 15 February 2013.

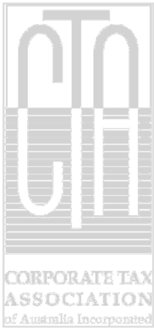
We have attached for the Committee's information copies of the CTA's December 2012 submissions on the earlier exposure drafts for the anti-avoidance measures and the transfer pricing changes respectively.

We maintain that both the proposed changes to transfer pricing and the anti-avoidance measures represent an over-reaction to the Taxation Office losing particular court decisions. In our view, these losses were not caused by deficiencies in the legislation, but rather by the Taxation Office's case selection and its approach to running the cases in litigation.

Transfer Pricing

In relation to the proposed transfer pricing changes, a number of the issues raised in our submission have been addressed in part in the current Bill and associated Explanatory Memorandum.

Level 11, 455 Bourke St,
Melbourne Victoria 3000
Telephone: (03) 9600 4411
Facsimile: (03) 9600 4055
Email Address: admin@corptax.com.au



However, we remain concerned about a number of significant aspects:

- The scope of the Commissioner's power to reconstruct actual transactions appears to be very broad and to go beyond what is contemplated by the OECD Guidelines. Heavy reliance is placed on the Explanatory Memoranda and guidance material to read down the words in the Bill so as to align the Bill to OECD principles. However, the Courts have recently down played the role of Explanatory Memoranda in statutory interpretation, and there is a significant risk that the Commissioner will use this power routinely in circumstances other than the "exceptional circumstances" the OECD contemplates.

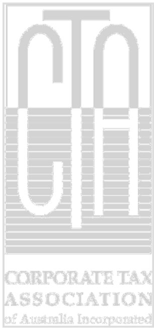
- In particular, proposed sec 815-130(4), which deals with instances where independent entities dealing with each other at arm's length would not have entered into any transactions with each other at all, has no equivalent rule in the OECD Guidelines. It is not entirely clear what this provision is attempting to achieve but if, as we have been assured, the aim of Schedule 2 of the Bill is no more than to import the OECD Guidelines into the Australian domestic law, then it should not include provisions that are not to be found in the OECD Guidelines.

- The documentation requirements are still quite onerous. The standard and scope of the documentation required to meet the requirements of the Bill is very high. Given the significant adverse consequences of having documentation that does not meet these strict requirements, the time frame allowed for document preparation is extremely limited and should be extended.

- The seven year time limit for amendments is too long. It should be four years, the same as other tax matters, some of which can be at least as complex as transfer pricing matters.

- There should be a statutory materiality threshold of $10 million before the transfer pricing rules may be applied.

- Finally, the Bill (as did the earlier draft) fails to deal effectively with the direct conflict between Customs Duty and the transfer pricing valuation rules, which presents an ongoing dilemma for Australian importers. In making a transfer pricing adjustment the Commissioner should be required to set out precisely how the adjustment impacts on individual transactions.



Broadly speaking, we consider that importing the OECD transfer pricing Guidelines into the domestic law on a prospective basis is something that business should be able to adjust to. However, we are concerned that the Bill has not successfully executed this policy objective. In our view, the Bill should be tested further before it is passed to ensure that it is both robust and workable, and will stand the test of time.

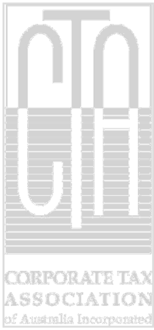
The General Anti-avoidance Rules

The CTA acknowledges the need for a robust and effective General Anti-Avoidance Rule to protect the revenue in circumstances where the specific tax rules may be open to abuse. However, we have consistently maintained that the proposed changes represent an over-reaction to the Taxation Office losing a number of court decisions that have quite limited application. In addition, they appear to go beyond the scope of the then Assistant Treasurer's policy announcement in March 2012.

The business community remains concerned that the amended legislation could be administered in a way that would create unexpected tax liabilities in relation to genuine commercial transactions containing no element of contrivance or artificiality. The uncertainty that would persist until judicial determination of a number of the new concepts introduced would constrain commercial activity and adversely affect everyday business decision-making.

The amended Bill does represent an improvement over the earlier draft in the way in which it forecloses on the "do nothing" argument (i.e. where some taxpayers have successfully argued that without the offending tax benefit they would not have proceeded with the relevant transaction at all). However, the use of the test 'a reasonable alternative' in proposed sec 177CB(3) introduces a degree of uncertainty for taxpayers in assessing alternative postulates as 'a reasonable alternative' may not always be the most likely alternative.

Proposed sec 177CB(4) qualifies whether a postulate is a reasonable alternative to the scheme identified by the Commissioner. We think that the qualifications in proposed sec 177CB(4)(a)(i) and (ii), which require that the alternative postulate should as far as possible align with the substance of the scheme and its results and consequences, are sufficient in themselves to foreclose on the sorts of arguments that were put in the relevant cases. For example, if the underlying transaction in the scheme involved the disposal of an asset to a third party, the alternative postulate would be expected to do likewise and it would not be open to a taxpayer to argue that he would have retained the asset absent the scheme.



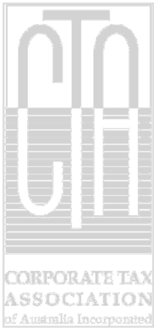
But the Bill goes further and in proposed sec 177CB(4)(b) also sets up a "disregard tax" presumption. While such a rule might have some intuitive appeal, it is in fact unnecessary to overcome the "do nothing" argument – the "substance of the scheme" and "result or consequence of the scheme" rules already have that effect.

There is a risk that a "disregard tax" rule could potentially be open to abuse by the Commissioner, as it could empower him to construct an alternative postulate that involves what is clearly an excessive amount of tax – for example by taxing the same economic gain twice. It has been suggested in the consultation process that such an outcome would be unlikely as the Commissioner would still have to be successful on the "purpose test" in sec 177D. However, it is far from clear how the purpose test would displace a statutory assumption that tax should be disregarded or how the courts would interpret such a rule.

Giving the Commissioner the extraordinary power to raise "maximum tax" assessments is in the CTA's view quite unnecessary to deal with whatever mischief has been caused by a small number of court cases that are largely confined to their own facts. It also far exceeds the scope of the 1 March government announcement.

The proposed amendments could severely impact a taxpayer's ability to restructure their affairs for legitimate business reasons. Below are two examples of relatively typical transactions within corporate groups which could potentially be impacted by the proposed changes.

> ***Example 1***
> *Company A, the head entity of a consolidated group, owns 100% of the shares in Company B. The Company A tax consolidated group has carried forward capital losses, but does not have any carry forward revenue losses.*
>
> *Company B owns two businesses and the majority of the assets of Company B consist of depreciable plant and equipment. Company B agrees to sell one of its businesses to a third party. Company A sets up Company C, also a 100% owned subsidiary of Company A. Company B transfers the assets that the group wishes to retain to Company C. Company A then sells Company B, realising a capital gain.*
>
> *Is the restructure of the consolidated group's assets prior to the sale a scheme to which the revised Part IVA would apply? What about the decision to sell the shares in Company A rather than the underlying assets (assuming the purchaser was indifferent)?*



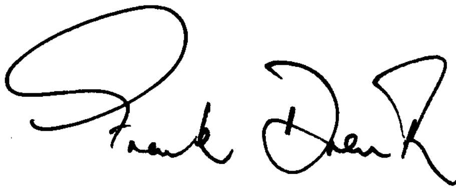
Example 2
Aust Co owns 100% of the issued shares of Foreign Co, a company resident in the UK. Foreign Co has historically been profitable and has a history of paying annual dividends to Aust Co. A third party offers to acquire Foreign Co from Aust Co. Prior to the execution of the transaction, Foreign Co pays a dividend to Aust Co equal to its retained profits. The consideration payable by the third party acquirer is reduced by an amount equal to the dividend paid. The dividend is exempt in the hands of Aust Co pursuant to Sec 23AJ. The sale of Foreign Co by Aust Co results in a taxable capital gain in the hands of Aust Co.

Is the exempt pre-completion dividend a scheme to which the revised Part IVA would apply?

We also believe there is a technical deficiency in the drafting of proposed sec 177C(1)(g). In its interaction with proposed sec 177C(1)(bc), it appears to define the tax benefit in a withholding tax scenario as being the gross amount on which tax would be withheld, rather than the quantum of the withholding tax benefit itself.

We would be pleased to provide further information or clarification for the Committee, should that be required.

Yours sincerely,



(Frank Drenth)

Executive Director