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Tax insights
Multinational tax avoidance measures

Snapshot

The Tax Laws Amendment (Combating Multinational Tax Avoidance) Bill 2015, (the Bill), containing new multinational tax integrity measures was introduced into Parliament by the Treasurer on 16 September 2015. The Government expects that the Bill will become enacted law later this year. The Bill includes:

- The multinational anti-avoidance law (MAAL) to amend Australia's general anti-avoidance provisions in Part IVA to "negate certain tax avoidance schemes used by multinational entities to artificially avoid the attribution of business profits to a permanent establishment in Australia";
- Measures to implement the OECD country-by-country (CbC) reporting obligations in Australia;
- A substantial increase in penalties in relation to tax avoidance cross border transactions; and
- A definition of 'significant global entities' that each of the three above provisions will apply to, being groups broadly with global income of A$1 billion or more.

Exposure Draft (ED) legislation in respect of the MAAL was originally released on 12 May 2015 (the draft MAAL) when the announcement was made as part of the Federal Budget. ED legislation on the CbC and penalty provisions was released on 6 August 2015. Both measures have been subject to consultation. The Bill differs in parts from the original ED legislation and the accompanying guidance in the explanatory materials (EM) has been expanded: the more important changes are discussed below.

Multinational anti-avoidance law (MAAL)

When first announced, the MAAL was said to affect some 30 multinational companies with "the most egregious tax structuring". The Government is now referring to:

- up to 100 companies potentially needing to review their arrangements to make sure they comply with the new law; and
- 1,000 multinationals operating in Australia with global revenues above $1 billion needing to consider the new rules if they have economic activities in Australia but book their Australian sales revenue offshore.

This expanded scope is not unexpected – it was always considered that the MAAL could apply to many companies across a wide range of industries.

Overview

The MAAL will amend Australia's general anti-avoidance provisions in Part IVA of the Income Tax Assessment Act 1936 (ITAA 1936). The MAAL will apply where:

- A foreign entity (referred to below as the Principal) derives income from making a supply (defined broadly but excluding certain financing arrangements) to an Australian customer who is not a member of the global group to which the foreign entity belongs. Supplies made by foreign entities to a wholly owned Australian subsidiary should not be caught;
- An entity in Australia (referred to below as the Australian Service Provider) that is associated with or commercially dependent on the Principal undertakes activities in Australia that are directly in connection with the supply;
- Some or all of the income derived by the Principal is not attributable to an Australian permanent establishment (PE) of the Principal; and
- It would be concluded, based on a number of prescribed factors, that a principal purpose of the scheme was to obtain an Australian tax benefit (as generally defined in Part IVA), or to obtain such a tax benefit and to reduce or defer foreign tax liabilities. This purpose threshold is substantially lower than the "sole or dominant" purpose test used in the general provisions of Part IVA.

In assessing purpose, the Commissioner must have regard to the usual matters referred to in Part IVA as well as:

- the extent to which activities that contribute to bringing about the contract for the supply are in fact, and are able to be, performed by the Principal, the Australian Service Provider or other entities. This is intended to ensure that schemes that have been split in such a way so as to fall short of PE status are more likely to be caught. The analysis will focus attention on the capacity of the various entities to undertake activities as well as what the entities in fact do. Based on the examples, it can be seen as a "quasi-substance" test - the more substance that exists in the Principal, the less likely will it be concluded that there was a principal purpose to reduce tax.
- the operation of foreign tax law in relation to the scheme. That is, the amount of foreign tax paid on the relevant Australian-related income is to be considered in the context of purpose – the higher such foreign tax, the less likely will it be concluded that there was a principal purpose to reduce tax.

Consequences of MAAL applying

The MAAL forms part of Part IVA and as a result, is premised upon the identification of a counterfactual – a hypothetical alternative to what in fact took place. Based on this counterfactual, the Commissioner then determines a tax benefit and issues an assessment to give effect to that determination. The EM addresses this matter only at a high level and leaves much uncertainty about the consequences of the MAAL applying.

In respect of the counterfactual, the EM says that the typical counterfactual will be a notional PE including all of the activities of the Australian Service Provider and the functions, assets and risks of the Principal which are associated with formally concluding the contracts. Having identified such a notional PE, the EM states only in general terms that the next step is to work out the profits attributable to that notional PE.

Reference is made in the EM to the arm's length principle and the approach set out in Division 815-C of the Income Tax Assessment Act 1997 (ITAA 1997), and in accordance with Australia's tax treaties (e.g., the OECD approach to attribute profits to permanent establishments).

In some cases, the Principal may be making payments of interest or royalties. The EM proposes two possible points of attack on such payments, either that such payments are:

- Subject to Australian withholding tax, to the extent that the payments are incurred with respect to the notional PE; or
- Treated as non-deductible in computing the profits attributable to that notional PE (on the basis that withholding tax has not been paid)

Structures that involve the payment by the Principal of such upstream interest or royalties require particular attention in computing the potential impacts of the MAAL. In addition to the potential income tax liability (profits attributable to a notional PE) and withholding tax liability (upstream interest or royalties), a base penalty can be imposed equal to 100% of the tax liability. Thus, where MAAL is activated, the consequences are potentially significant. That is, it is more than a transfer pricing adjustment in relation to profits attributable to a deemed Australian PE; the rules bring into the scope of Australian tax payments made offshore for the use of intangibles and intellectual property, significantly increasing the ambit of Australian tax.

Further guidance will be required to calculate the potential Australian tax payable. The ATO is expected to issue guidance material before the end of the year.

Part IVA generally takes precedence over Australia's tax treaties. This feature should prevent a treaty-based argument that the Principal does not have a PE in Australia under the relevant treaty.

Notable changes

A number of notable changes as compared to the draft MAAL have been made:

- The conditions in the draft MAAL required that the Principal or a group member was (subject to some exceptions) connected with a no tax or low tax country. This test has been removed.
- The draft MAAL also had a second purpose test: whether the scheme was "designed to avoid" a PE. This test has also been removed.

By removing some of the gateway tests for the MAAL to apply, the scope of the MAAL has been widened, or as the Government notes, it has been "strengthened".

Under the draft MAAL, the "no tax or low tax" condition operated to ensure that the MAAL would not apply where the relevant Australian-related income was subject to "sufficient" foreign taxation. In such a case, Australia did not activate the MAAL. The level of foreign tax has been removed as a gateway test – although the Commissioner is required to consider such matters when assessing purpose.

Start date

The MAAL will commence from 1 January 2016 (irrespective of when the scheme was entered into) and will apply to tax benefits derived after that day.

Next steps

The intent of the Government and the ATO is that the MAAL will lead to behavioural change. The Commissioner of Taxation stated in a joint press conference with the Treasurer on 16 September 2015 that "I hope we raise no revenue from these new [MAAL] provisions because I hope that these multinational companies will do the right thing, will restructure their investments into Australia in such a way that they leave the profit that clearly arises from this economic activity back here in Australia, and have that subject to our 30 per cent company tax rate".

In other words, companies may potentially restructure their operations to fall outside of MAAL. This response could involve many alternatives depending upon the relevant facts. One example would be for the Principal to engage a service provider in Australia that is neither an associate nor commercially dependent. Another option (which is implicit in the Commissioner's comments above) is that the multinational may convert their Australian sales to a buy/sell arrangement through an Australian subsidiary. The Australian subsidiary would contract with local customers, book the revenue, and then make payments (subject to arm's length transfer pricing principles and Australian withholding tax rules) to the Principal or other parties. Alternatively, it may take a view that a PE of the Principal exists in Australia, and attribute profits accordingly.

Where restructures are contemplated, but are not completed by 1 January 2016, the EM states that the "ATO has indicated that it can adopt a flexible approach to administering the law ... For multinationals that voluntarily approach the ATO, penalties can be waived and specific arrangements can be made regarding compliance. This is under the Commissioner's discretional powers and is dependent on the relevant facts and circumstances of each case".

Country-by-Country reporting obligations

In Australia's May 2015 Budget, the Treasurer committed Australia to action on several key BEPS initiatives including OECD standards under Action 13 on Country-by-Country (CbC) reporting as well as the transfer pricing (master file / local file) documentation for income years starting on or after 1 January 2016.

The Bill requires members of a group with global income of A$1 billion or more with a relevant Australian connection to lodge three "statements", being a CbC report, a transfer pricing master file and a transfer pricing local file with the ATO. Lodgement is due before the end of the next income year (e.g. lodgement will be due with the ATO by 31 December 2017 in respect of the year commencing 1 January 2016, or lodgement with the ATO by 30 June 2018 in respect of the year commencing 1 July 2016).

The Australian connection test is such that the obligation will fall on Australian residents, a resident trust and a partnership with at least one Australian resident partner, as well as non-resident entities operating through a PE in Australia.

The EM states that the provisions will apply to a tax consolidated group, such that the obligation to lodge one or more of the statements will rest with the head company on behalf of the group.

The Commissioner may:

- exempt a particular entity;
- determine by legislative instrument that these provisions do not apply to a "specified class of entity".

When considering whether to grant an exemption, the EM states that the Commissioner may take account of:

- The risk profile including the extent of international related party dealings;
- The compliance burden
- Whether the Commissioner will receive the relevant statement(s) by alternative means – such as via Exchange of information with the tax authority in the parent company's home jurisdiction.

More comprehensive guidance will be provided by the ATO in respect of exemptions.

The Bill proposes that taxpayers are required to lodge such statements with the ATO in the "approved form" and the EM confirms that the ATO is working to provide guidance on the relevant content. We assume that the "approved form" will essentially replicate the OECD reporting template for CbC reporting, master file and local file.

The existing administrative penalties in Australia's tax laws, not linked to tax payable, can be imposed for failure to lodge these statements. The EM notes that a taxpayer that fails to lodge these statements would still be eligible to have a Reasonably Arguable Position on a transfer pricing matter if it met the existing documentation requirements in respect of Division 815 in ITAA 1997.

There will be many challenges faced by companies preparing for the commencement of the CbC and related rules:

- The documentation and reporting burden for groups operating in Australia will increase significantly from 1 January 2016. There will be many practical issues in navigating the different requirements of existing Australian documentation and proposed OECD master file and local file requirements. Although there will be many similarities between, for example, the OECD local file and the Australian documentation requirements, there are likely to be differences. Ensuring consistency of information across all documents will be challenging;

- In addition, the different dates for preparation / filing of such documents (e.g. subdivision 815-B documentation needs to be prepared before lodgement of the tax return for an income year whilst master file / local file is only expected to be filed by the end of the next income tax year) will cause practical challenges for taxpayers;
- There is debate in the US as to whether and how the CbC and transfer pricing reporting regime is to be introduced. US Treasury had indicated that the US would be an early adopter and would implement via regulation, however, more recently Congress has challenged this and indicated that CbC reporting may require legislative action by Congress. If so, this could delay implementation in the US. Such delays could well expose the Australian subsidiaries of US MNCs to CbC reporting requirements to the ATO, pending any possible future CbC filing requirements in the US;
- There will likely be differences in the timing of adoption of CbC reporting across jurisdictions. In this context, an Australian subsidiary may have to provide a CbC report (or master file report) where, for example, its parent's home jurisdiction has not yet legislated for CbC reporting.

Taxpayers should begin preparation for these new CbC and transfer pricing documentation requirements. The increased flow of information with tax authorities is likely to drive considerable audit activity across many jurisdictions. Some suggested actions in the short-term include:

- Ensuring that parent company planning for data gathering takes into account the Australian implementation date;
- Ensuring that appropriate systems are in place to capture and report relevant data before the start of the first affected year;
- Anticipating potential audit enquiries that may be triggered by data contained in the CbC and transfer pricing documentation;
- Reviewing existing transfer pricing policies, structures and documentation and consider approaches to deal with any inconsistencies.

Increased penalties

The Bill also includes the legislation which will impose stronger penalties intended to combat tax avoidance and profit shifting activities by multinational groups, with global income of A$1 billion or more. The amendments would not apply to taxpayers who have adopted a "reasonably arguable position".

The table below shows the new penalties, expressed as a percentage of the tax shortfall identified:

Base penalty	Aggravating factors	Disclosure during examination	Disclosure before examination
Tax avoidance schemes			
100%	*120%*	*80%*	*20%*
If position is reasonably arguable			
25%	*30%*	*20%*	*5%*
Profit-shifting schemes			
50%	*60%*	*40%*	*10%*
If position is reasonably arguable			
10%	*12%*	*8%*	*2%*

The new penalties will apply to tax benefits obtained in relation to an income year commencing on or after 1 July 2015, regardless of when the scheme was entered into.

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