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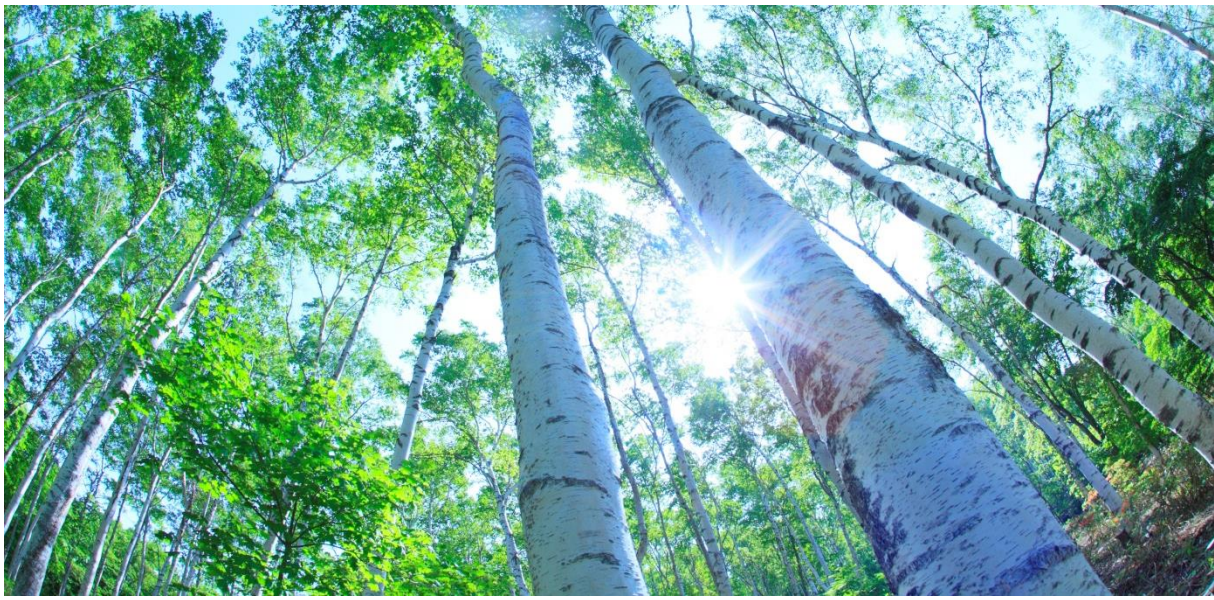
Tax insights
Multinational anti avoidance - Update



Snapshot

Following the Treasurer's announcement the day before the 2015-16 Federal Budget of an integrity measure specifically aimed at addressing multinational tax avoidance, Treasury has released Exposure Draft legislation - draft Tax Laws Amendment (Tax Integrity Multinational Anti-avoidance Law) Bill 2015.

Please see our Tax insights dated 11 May 2015. This Tax insights provides further analysis based on the draft legislation.

The Explanatory Memorandum ("EM") released with the Exposure Draft legislation indicates that the new provisions are only intended to target "the most egregious tax structuring by multinational entities, while limiting the impact on legitimate international business activities".

The EM explains that the draft legislation will introduce changes to 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".

From patience to prosperity?

The draft legislation targets both the business profits that would have been attributable to an Australian permanent establishment and obligations arising under royalty and interest withholding tax. The focus on withholding tax in addition to business profits is important as the withholding tax revenue could potentially exceed the revenue derived from taxing business profits.

The measure will apply where:

- a non-Australian resident makes a supply to an unrelated Australian resident;
- the income derived by the non-resident is not attributable to an Australian permanent establishment of that non-resident;
- activities are undertaken in Australia in connection with the supply;
- some or all of those activities are undertaken by an Australian resident (or an Australian permanent establishment of an entity) which is an associate of, or commercially dependent on, the non-resident;
- it is reasonable to conclude the scheme is designed to avoid the non-resident deriving income attributable to an Australian permanent establishment of the non-resident;
- a principal purpose is to enable a taxpayer (the non-resident or another entity) to obtain a tax benefit, irrespective of whether the scheme also reduces foreign taxes or other Australian taxes (e.g. GST) or foreign taxes; and
- the foreign resident is connected with a no or low tax jurisdiction (see below).

This framework is broadly consistent with the Treasurer's announcement but contains some important clarifications of several matters. These include:

Very broad scope of dealings with Australians

The legislation applies to a far broader scope of dealings with Australians than the supply of goods and services. According to the EM, the measure will potentially apply to non-residents with a very broad range of dealings with Australians, including "the supply of electronic material, advertising services, downloads, the provision of data, intellectual property rights, and the right to priority in search functions."

However, only dealings with non-associated Australian residents are caught

The legislation will only apply where the non-resident deals with an Australian resident who is not an associate. Therefore, supplies made by non-residents to or through an Australian subsidiary will not be caught. This is an important limitation on the measure and will exclude many multinationals from its scope.

Foreign taxes and Australian non-income taxes are relevant to the purpose test

Treasury has recognised that focussing only on Australian tax benefits could be problematic for this measure. The EM provides an example of a group which uses an identical structure throughout the region which has been designed to avoid the creation of permanent establishments in a number of countries in the region. The Australian operations are a relatively small part of the group's regional operations.

Ordinarily, it would be possible to argue in such a case that any purpose of obtaining an Australian tax benefit was only a minor purpose of the overall structure given the relatively small size of the Australian operations.

The draft legislation seeks to counteract this argument by testing purpose with regard not only to the Australian tax benefit but also to foreign income tax benefits and Australian non-income tax benefits (such as GST).

It should be noted that while purpose is tested with regard to all of these taxes, only the Australian tax benefit (as determined under Part IVA) can be attacked by this measure – it is not seeking to prevent avoidance of foreign taxes or Australian taxes other than income tax.

Profits "channelled" to tax havens – broader than it seems

While the Treasurer's announcement referred to profits "channelled" to tax havens, the draft legislation includes what is arguably a much broader category of profits.

The measure will apply where a non-resident is "connected with" a no tax / low tax country. This

will be the case where the non-resident or any other member of its global group conducts any activities which give rise to income that falls within either of the following categories:

- Income subject to no tax or a low rate of tax by virtue of either a law of a foreign country or an arrangement with the government or an authority of a foreign country. It is important to note that a "low rate of tax" is not defined either in the legislation or the EM
- "stateless income" - income that is not subject to tax in any country.

Many multinationals would have some income subject to low or no tax and therefore would come within this aspect of the test. However, there are then two carve-outs:

1. Where the activities generating the no or low-taxed income are not related directly or indirectly to the Australian dealings; or
2. Where the entity undertaking the activities undertakes "substantial economic activity" in the no or low-taxed country.

It is again important to note that "substantial economic activity" is not defined.

Finally, in a doubling down of the onus of proof on the taxpayer, these two carve-outs will not be available unless the taxpayer gives the Commissioner information that "establishes" that the carve-outs apply. The EM explains that "[p]lacing the burden of proof on the non-resident is necessary due to the difficulty the Commissioner would face in trying to trace income through multiple jurisdictions."

However, no guidance is provided on the level of information that might be required.

This is a significant measure that multinationals will need to carefully consider. The measures will apply to tax benefits arising on or after 1 January 2016 irrespective of the date the scheme was entered into or commenced.

The Government is seeking submissions in respect of the draft legislation prior to 9 June 2015.

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