

Tax insights

Australian diverted profits and GST measures



Snapshot

After much media speculation, and just a day before the 2015-16 Federal Budget, the Treasurer, the Hon. Joe Hockey MP, has announced that Australia will introduce a new integrity measure specifically aimed at addressing multinational tax avoidance in respect of diverted profits. The measure is intended to apply from 1 January 2016.

From patience to prosperity?

The Treasurer also announced that the GST will be extended to digital supplies made in Australia by offshore suppliers.

Diverted profits measure

The diverted profits announcement follows on from the recent collaboration announced by the Treasurer with the UK in relation to multinational tax. The announcement targets 30 identified (but not publicly disclosed) multinational enterprises.

Few details were released on 11 May 2015. Draft legislation for consultation is expected to be issued on 12 May 2015.

The announcement comes shortly before an expected revised discussion draft from the OECD on permanent establishments (Action 7).

The announcement **proposes changes to Australia's general anti-avoidance provisions** in Part IVA to address circumstances where multinational companies are "diverting profits earned in Australia away from Australia to no or low tax jurisdictions". The announcement considers that the targeted arrangements, including "Double Irish Dutch Sandwich" arrangements, are being to avoid paying **Australian tax**.

Importantly under Australian tax law, **the general anti-avoidance provisions generally take precedence over Australia's tax treaties**. The introduction of the measure by amending the anti-avoidance provisions is presumably intended to counter the treaty-based argument that the multinational does not have a permanent establishment in Australia, and so should not be liable to Australian tax on business profits.

The Treasurer indicated that there is "a lot of interest" from other countries "potentially including China" and he indicated that other countries may introduce similar laws. Australian companies selling goods and services into foreign countries will need to carefully consider the potential application of similar measures by other countries.

Who is impacted?

Based on the limited details provided in the announcement, the measures will target 30 identified (but not publicly disclosed) multinational enterprises with **global revenue in excess of AUD 1 billion** where:

- Foreign multinationals supply goods or services to Australians;
- Revenue from **Australian sales is booked offshore**;
- **Local dealings**: Australian customers deal mainly with Australian employees;
- **Profit ends up in a tax haven**: **Australian sales revenue** is channelled to tax havens; and
- Tax avoidance purpose: A **principal purpose** of the scheme was **to avoid a taxable presence in Australia**.

What are the consequences?

Where the provisions apply, the result is:

- Income tax on profits;
- Withholding tax on royalties and interest;
- Interest on unpaid taxes; and

- Penalties of 100% of unpaid taxes.

Possible example

Based on the example outlined by the Treasurer, consider the following:

- Foreign Sales Co is a subsidiary of MNE, a multinational enterprise, and is not an Australian resident
- Foreign Sales Co sells goods or services to Australian customers and books the sales revenue
- AusCo undertakes some activities in Australia which have some connection to the sales
- Foreign Sales Co pays amounts, directly or indirectly, to one or more related companies in a "tax haven"

These issues raise a number key questions for multinationals doing business in Australia.

Australian sales revenue is booked offshore: while scant detail is available, this seems to be looking at the specific transaction between the multinational group and the Australian customers. Per the above example, the sales revenue from the Australian customers is booked by Foreign Sales Co, which is not an Australian resident.

Local dealings: This seems to asking whether Australian customers are mainly dealing with Australian based persons, presumably who are employees of an entity other than Foreign Sales Co. Where the Australian based employees undertake "minor Australian activities", this test will not be met.

Profits "end up" or are "channelled" to tax havens: Based on the Treasurer's example, this seems to be looking at upstream payments being made between group entities, where those payments are, in a broad sense, ultimately attributable back to the sales income derived by Foreign Sales Co from Australian customers. These payments may be interest, royalties or other related party payments, which are, in some sense, connected with the supply chain that was part of the flow of goods or services sold into Australia.

Where a multinational is not using a tax haven in its structure in respect of such revenue, the measures will not apply. No definition of a tax haven has been provided as yet.

Principal purpose: the test asks whether there was a principal purpose of avoiding a taxable presence in Australia. This implies that Foreign Sales Co does not have a permanent establishment in Australia, under existing law. It would appear that the purpose threshold is something lower than the sole or dominant purpose test typically used in Part IVA.

Implications

The underlying logic behind this announcement is consistent with the recent material issued by the Australian Taxation Office which seeks to identify the “channel profit” or total worldwide profit derived by various members of a worldwide group, which is broadly attributable to business activities involving Australia. This whole-of-group view is necessary to identify whether relevant profits (ie, profits relevantly connected with Australia) have been channelled to tax havens.

Increased Australian corporate tax: the announcement indicates that there will be income tax on profit, but at this stage, there is no detail on how to determine the profit that is to be subject to this measure.

The corporate tax liability of an affected enterprise could be significantly higher than would otherwise be the case.

Withholding tax implications: the announcement indicates that Australian withholding tax can be imposed on royalties and interest. This is presumably in respect of the upstream payments which are being “channelled to tax havens.” Such payments are unlikely being subjected to withholding tax at present (although may already be subject to foreign withholding tax).

The operation of Australian tax treaties in such cases would require further analysis.

Penalties and interest: the announcement provides that the Commissioner will have the ability to impose a fine equal to 100% of unpaid taxes plus interest.

GST on digital supplies

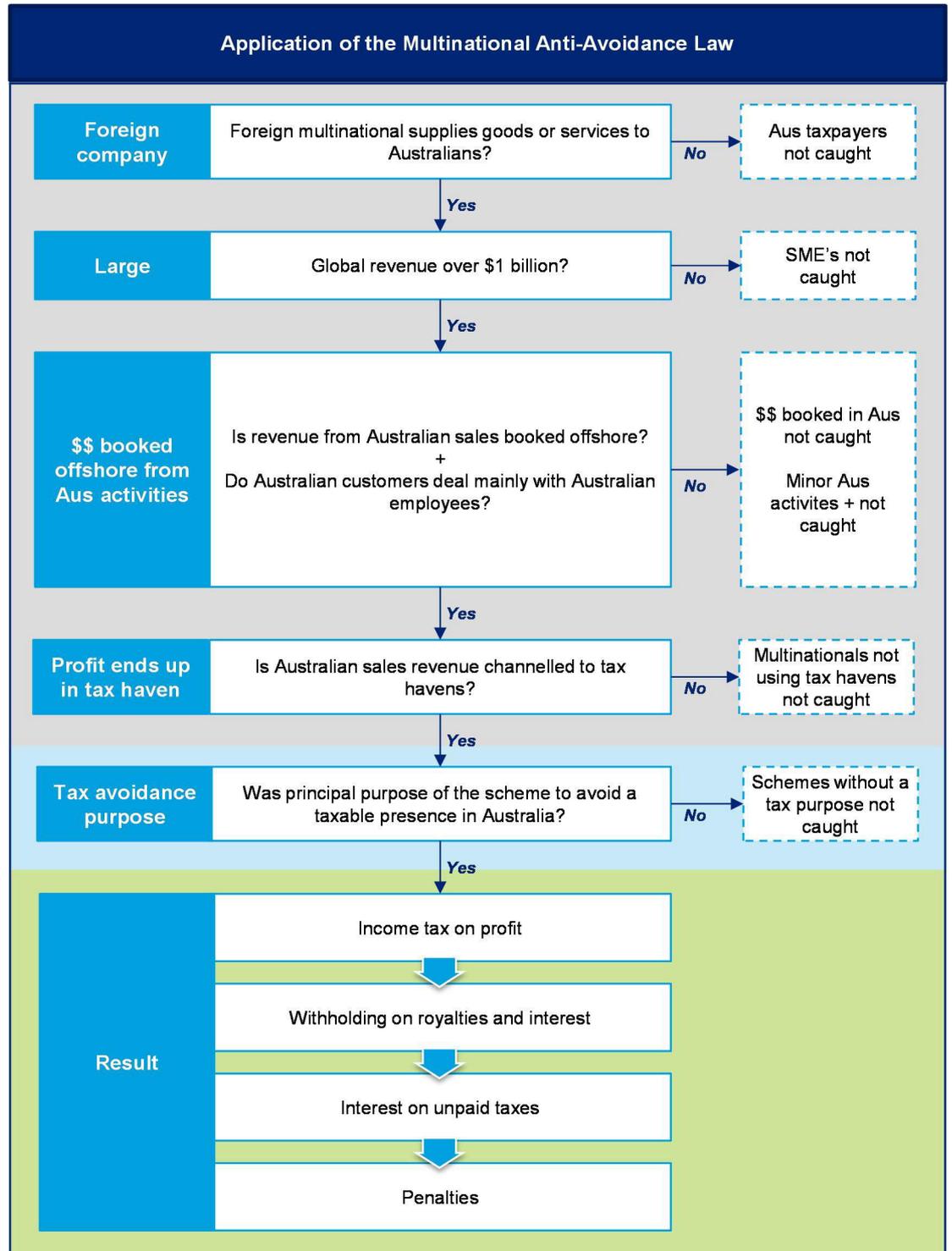
The Treasurer also announced that Australia will introduce measures to ensure that the supply by offshore suppliers of digital products and services in Australia will be subject to GST.

The announcement references the work of the OECD under the BEPS project on similar issues and actions taken by a number of countries to address the indirect tax implications of the supply of intangibles and digital services online.

The Treasurer’s estimate of the incremental tax revenue from the proposed measure is \$350m over 4 years.

Additional Tax insights will be issued by Deloitte in respect of these matters as further details become available.

Appendix – Application of the proposed diverted profit measures



Contacts

For more information, please contact

Vik Khanna

Partner

+61 (3) 9671 6666

vkhanna@deloitte.com.au

David Watkins

Partner

+61 (2) 9322 7251

dwatkins@deloitte.com.au

Mark Hadassin

Partner

+61 (2) 9322 5807

mhadassin@deloitte.com.au

Fiona Craig

Partner

+61 (2) 9322 7770

ficraig@deloitte.com.au

Claudio Cimetta

Partner

+61 (3) 9671 7601

ccimetta@deloitte.com.au

For further information, visit our website at www.deloitte.com

This publication contains general information only, and none of Deloitte Touche Tohmatsu Limited, its member firms, or their related entities (collectively the "Deloitte Network") is, by means of this publication, rendering professional advice or services. Before making any decision or taking any action that may affect your finances or your business, you should consult a qualified professional adviser. No entity in the Deloitte Network shall be responsible for any loss whatsoever sustained by any person who relies on this publication.

About Deloitte

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see www.deloitte.com/au/about for a detailed description of the legal structure of Deloitte Touche Tohmatsu Limited and its member firms.

Deloitte provides audit, tax, consulting, and financial advisory services to public and private clients spanning multiple industries. With a globally connected network of member firms in more than 150 countries, Deloitte brings world-class capabilities and high-quality service to clients, delivering the insights they need to address their most complex business challenges. Deloitte's approximately 195,000 professionals are committed to becoming the standard of excellence.

About Deloitte Australia

In Australia, the member firm is the Australian partnership of Deloitte Touche Tohmatsu. As one of Australia's leading professional services firms, Deloitte Touche Tohmatsu and its affiliates provide audit, tax, consulting, and financial advisory services through approximately 6,000 people across the country. Focused on the creation of value and growth, and known as an employer of choice for innovative human resources programs, we are dedicated to helping our clients and our people excel. For more information, please visit our web site at www.deloitte.com.au.

Liability limited by a scheme approved under Professional Standards Legislation.

Member of Deloitte Touche Tohmatsu Limited

© 2015 Deloitte Tax Services Pty Ltd.