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Tax Insights

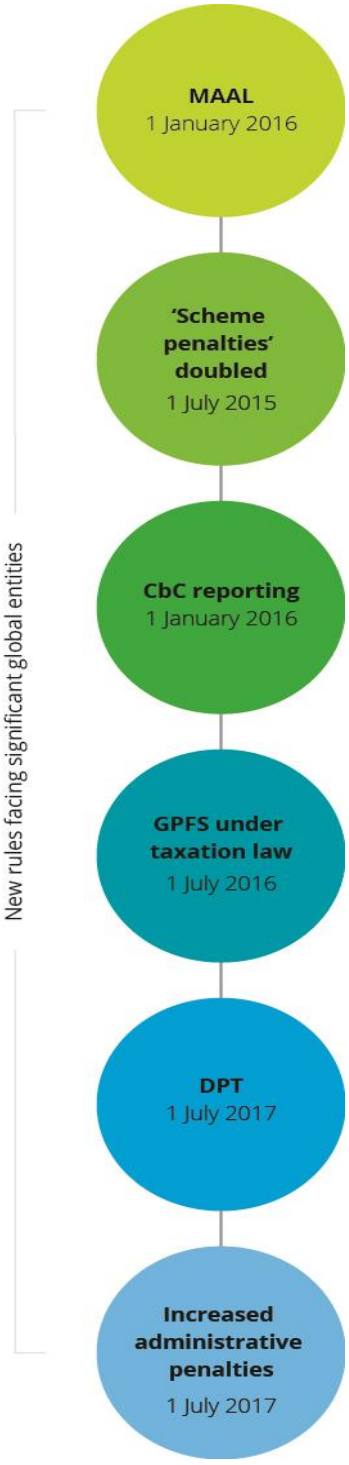
More headaches for more Significant Global Entities: Part 2

Snapshot

With more taxpayers potentially within the definition of SGE (refer Deloitte Tax Insights More headaches for more Significant Global Entities: Part 1), it is timely to revisit the obligations of a SGE. These include:

- The doubling of penalties from 1 July 2015 in respect of tax avoidance schemes and profit shifting activities where there is no "reasonably arguable position"
- The MAAL, which has applied from 1 January 2016, targeting multinational entities that seek to avoid having a taxable presence in Australia
- CbC reporting from 1 January 2016

- The need to lodge general purposes financial statements with the ATO if not already required with Australian Securities and Investments Commission (ASIC), applicable from 1 July 2016
- The DPT which from 1 July 2017 targets tax benefits in connection with schemes involving foreign associates and the diversion of profits to medium-to-low tax countries
- Significantly increased administrative penalties where tax documents are lodged late, or false or misleading statements are made, from 1 July 2017.



Increased penalties

Failure to lodge (FTL) penalties

Failure to lodge penalties have extremely wide application, and will apply to late or non-lodgment of all tax documents by SGEs that are required in an approved form on or before a certain date.

The increased penalty regime for SGEs includes failing to lodge (FTL) on time documents including but not limited to:

- Income tax returns,
- Business activity statements
- Country-by-country reports
- General Purpose Financial Statements required to be given under the taxation law
- FBT returns
- Tax consolidation notices
- PAYG and taxable payment annual reports
- Information required to be lodged under the Common Reporting Standard (CRS) and FATCA regimes.

Previously the late lodgment of forms by a large taxpayer resulted in a maximum fine of $5,250: However, **a new multiplication factor of 500** (previously 5) is now applied to the base penalty amount for SGEs. **This results in a maximum penalty of $525,000 per document.**

FTL penalty for an SGE	
Days late	**SGE penalties**
28 or less	$105,000
29 to 56	$210,000
57 to 84	$315,000
85 to 112	$420,000
More than 112	$525,000

Administration of FTL penalties

Up until recently, the ATO had been taking an education approach to the new FTL penalty system. The ATO's approach has now evolved to:

- Warning letters will issue from the automated system
- The automated system will identify penalty impositions for SGEs as it does for all taxpayers
- Automatic penalty impositions for SGE taxpayers will be quarantined and they will be subject to a manual review by a case officer (This manual review may include contacting the SGE to discuss the penalty, and any extenuating circumstances that may give rise to remission)
- The penalty will be applied to the SGE's account.

Recently, we have observed that taxpayers are now being issued with penalty notices more frequently. For example, the late lodgement of a BAS has resulted in penalties in the hundreds of thousands of dollars.

The Commissioner does have a discretion to remit penalties if fair and reasonable, and PS LA 2011/19 sets out the circumstances in which the ATO is currently likely to remit a FTL penalty. Both the EM to the original bill and the ATO have stated that penalties for SGEs, even though larger, will be treated like all other penalties.

Taxpayers should note that under the current principles set out in PS LA 2011/15, there is an ability for the Commissioner to defer lodgment obligation and extend the due date for lodgment of a document, which provides additional time to lodge without incurring a FTL penalty. Taxpayers are encouraged to apply for an extension when needed.

False & misleading statements / failing to make a statement

From 1 July 2017, administrative penalties doubled for SGEs:

- Making false and misleading statements to the ATO, and
- Failing to give documents necessary to determine tax-related liabilities to the Commissioner on time (failing to make a statement).

Increases for false or misleading statements that do not result in a tax shortfall amount		
	Penalty Units	**From 1 July 2017**
No reasonable care	40	$8,400
Recklessness	80	$16,800
Intentional disregard	120	$25,200

If there is a tax shortfall, the penalties relating to statements are calculated as a percentage of the relevant amount of the tax shortfall depending on

the behaviours that led to the false or misleading statement, or failing to make a statement at all. This percentage will be doubled for SGEs.

Increases for false or misleading statements that result in a tax shortfall amount	
Penalty amount for culpable behaviour	**Base penalty amount applicable from 1 July 2017**
Failing to provide a document as required	150% of tax-related liability
Making a false or misleading statement & not reasonably arguable or failure to take reasonable care	50% of shortfall amount
Making a false or misleading statement & recklessness	100% of shortfall amount
Making a false or misleading statement & intentional disregard	150% of shortfall amounts

Doubling of penalties for tax avoidance or profit shifting

From 1 July 2015, SGEs were also subject to double the administrative penalties that can be applied by the Commissioner of Taxation where they enter into tax avoidance or profit shifting schemes.

For SGEs this means that the maximum penalty applicable is generally 100 per cent of the amount of tax avoided under the scheme (but can be up to 120 per cent where aggravating factors apply). Taxpayers that adopt a tax position that is reasonably arguable will not be liable to increased penalties.

MAAL

Applying from 1 January 2016, the multinational anti-avoidance law (MAAL) is designed to counter multinational entities using artificial or contrived arrangements to avoid the attribution of business profits to Australia through a taxable presence in Australia.

Broadly, the new law will apply if under the scheme, or in connection with the scheme:

- A foreign entity supplies goods or services to an Australian customer
- An Australian entity, that is an associate of or is commercially dependent on the foreign entity, undertakes activities directly in connection with the supply
- Some or all of the income derived by the foreign entity is not attributable to an Australian permanent establishment, and

- The principal purpose, or one of the principal purposes of the scheme, is to obtain an Australian tax benefit or to obtain both an Australian and foreign tax benefit.

Where a scheme is captured by the MAAL, the Commissioner of Taxation has the power to make a determination under Part IVA and, based on a reasonable alternative postulate, apply the tax rules as if the foreign entity had been making a supply through an Australian permanent establishment.

The ATO has released Law Companion Guideline LCG 2015/2 which outlines how the ATO will apply and administer the law. If taxpayers are impacted by the MAAL, the ATO's primary aim is not to apply the MAAL but to assist taxpayers to transition with certainty into compliant arrangements.

The ATO has also released a MAAL client experience roadmap which sets out how the ATO will engage with taxpayers.

For more information in relation to the MAAL, please refer to our Tax Insights here and here.

Diverted Profits tax

The Diverted Profits Tax (DPT), applicable from 1 July 2017, is intended to "ensure that the tax paid by SGEs properly reflects the economic substance of their activities in Australia and aims to prevent the diversion of profits offshore through contrived arrangements. It will also encourage SGEs to provide sufficient information to the Commissioner to allow for the timely resolution of tax disputes".

Broadly, the DPT applies if under the scheme, or in connection with the scheme:

- A taxpayer ('the relevant taxpayer') has obtained an Australian tax benefit in connection with the scheme in an income year
- A foreign entity, that is an associate of the relevant taxpayer, entered into or carried out the scheme or is otherwise connected with the scheme
- The principal purpose, or one of the principal purposes of the scheme, is to obtain an Australian tax benefit or to obtain both an Australian and foreign tax benefit
- None of the following exceptions apply:
    - The $25 million income test
    - The sufficient foreign tax test (this test focusses on the amount of foreign tax paid and not the rate of tax applied to that income)
    - The sufficient economic substance test.

Once potentially within scope, that then requires a detailed analysis of principal purpose, tax benefit and economic substance, all of which are open to considerable debate. **Hence, all related party cross border transactions where the foreign tax paid on the relevant income is less than 24% liability are potentially within the scope of the DPT.** It can apply both to foreign owned Australian entities (inbound cases) and Australian-based multinationals (outbound cases).

The consequences of a DPT assessment are punitive and include:

- A penalty tax rate of 40%
- Payment required within 21 days of the DPT assessment
- Limited review and restricted dispute processes
- Potential to result in unrelieved double tax across two or more jurisdictions
- No access to mandatory binding arbitration under the OECD Multilateral Convention

The ATO has published a Draft Law Companion Ruling LCR 2017/D7 to provide guidance on how the Commissioner will apply the new DPT law and, in particular, clarifies new concepts introduced by the measure to provide taxpayers with greater certainty on the application of the new law.

The ATO has also published a Draft Practical Compliance Guideline PCG 2018/D2 setting out the ATO's client engagement framework for the DPT, and outlining the ATO's approach to risk assessment and compliance activity when the DPT is identified as a potential area of concern.

For more information on the DPT, please refer to our Tax Insight here (in respect of ATO guidance) and here (in respect of DPT legislation).

Lodge General Purpose Financial Statements

Corporate tax entities that are SGEs and are either an Australian resident, or a foreign resident which operates an Australian permanent establishment, and do not currently lodge general purpose financial statements with the Australian Securities and Investments Commission (ASIC) must also furnish general purpose financial statements to the Commissioner of Taxation.

The Commissioner must give a copy of the GPFS to the Australian Securities and Investment Commission (ASIC). This copy will appear on ASIC's register and will be available to the public.

This requirement to lodge applies for income years commencing on or after 1 July 2016.

For more information, please refer to our Tax Insight here and the ATO website here.

Country by Country reporting

As part of the local implementation of the OECD's *Transfer Pricing Documentation and Country-by-Country Reporting*, *Action 13 – 2015 Final Report*, SGEs (soon CbCREs) have CbC reporting obligations for income years commencing on or after 1 January 2016.

SGEs are required to provide the ATO with a CbC report, a master file, and a local file within 12 months of the end of the applicable financial year in the specific format required by the ATO.

CbC report: SGEs have the primary obligation to obtain the CbC report and file it with the ATO, unless it is filed in a country that is signatory to the

Multilateral Competent Authority Agreement on Automatic Exchange of CbC Reports. Exemptions may be granted in limited circumstances.

Master file: An SGE must obtain a copy of the master file in English from its parent entity and file it with the ATO. The required contents of the master file are consistent with those outlined in Annex I to Chapter V of the OECD transfer pricing guidelines.

Australian local file: SGEs must prepare and lodge an Australian local file with the ATO. The Australian local file is an electronic file that must be lodged as an XML file in a specific format outlined by the ATO. The contents and the format of the Australian local file are not like those of a traditional transfer pricing report (for example, neither a functional analysis nor an economic analysis is required) and do not align with that outlined by the OECD in Annex II to Chapter V of the transfer pricing guidelines. The Australian local file should instead be seen as a far more detailed version of the International Dealings Schedule in that it will act as a more powerful risk assessment tool for the ATO to better identify risk review or audit candidates. The Australian local file consists of the following:

- Short form local file – a document that includes information relating to the three bullet points outlined under the "local entity" heading of Annex II to Chapter V of the transfer pricing guidelines. While all taxpayers will need to prepare a short form local file, those that do not exceed certain materiality thresholds and meet other criteria will not have to prepare or provide the ATO with any of the other information below.
- Part A of the local file – SGEs are required to provide transactional information on all international related-party dealings, including counterparties, type of dealing, amount, method used to price the dealing, level of documentation maintained to support the arm's length nature of the dealing, and the foreign exchange gain or loss incurred in relation to each dealing. The format of Part A of the local file is best described as being analogous to a highly granular, transaction-based version of the CbC report, with 26 disclosures required for every dealing. Given that Part A of the local file is in substance a more detailed version of the IDS, the ATO has indicated it will provide SGEs with an exemption from having to lodge the IDS should they voluntarily file Part A of the local file at the same time as they lodge their tax return.
- Part B of the local file – as an extension to Part A of the local file, SGEs are required to provide a further 18 disclosures for all "material" international related-party dealings in relation to the nature of agreements relating to those dealings.
- Other attachments – the SGE must attach copies of several files as part of its local file lodgement, including the master file, all intercompany agreements for "material" international related-party dealings, copies of foreign advance pricing agreements (APAs) that relate to Australian dealings and financial statements (noting that SGEs may need to prepare these as general purpose financial statements for income years commencing on or after 1 July 2016).

An SGE can apply to the ATO for an exemption from filing one or more of the CbC documents. For example, it can request an exemption from filing the CbC report for the first year of reporting on the grounds that the parent company jurisdiction is implementing CbC reporting requirements at a later

date than Australia. If an SGE has a different income year-end than its parent, it will need to make a written application to the ATO requesting the use of a 12-month period aligned with the income year of an SGE's parent entity (replacement reporting period) for the CbC report and master file.

For more information on the CbC reporting requirements, please refer to our Tax Insight here (OECD CbC reporting implementation package) and here (Draft legislation country by country reporting).

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