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No turning back

The tax landscape of 2018 and beyond

January 2018

2017: the year that was

2017 was a tumultuous year in politics: the dual citizenship saga, the vote on marriage equality and the tussle for a Royal Commission addressing banks and financial services.

Genuine Parliamentary debate on tax reform was sparse, and the legislation on the proposed corporate tax rate cuts was consumed by partisan claim and counter claim. The issue will come back on the agenda in early 2018, with the debate now coloured by the dramatic US tax reforms.

Meanwhile, the ALP has been busy and proactive in releasing a raft of tax policies, laying out a path of what taxation under the alternative Government would look like: key impacts would be additional transparency measures and a tightening of interest deductions.

Notable tax developments over the course of 2017 included the release of the anti-hybrid draft legislation, resolution of the Chevron litigation, the commencement of the Australian Diverted Profits Tax (DPT), significantly increased administrative penalties for multinationals and Australia's signing of the OECD Multilateral Instrument.

We also saw the release of draft anti-phoenixing and final whistleblower protection rules, the finalisation (but not the release) of the Black Economy taskforce report, a further extension of the Senate Inquiry into corporate tax avoidance, finalisation of the related party debt financing Practical Compliance Guide, release of ATO guidance on preparation of General Purpose Financial Statements, and progress on the long-awaited amendments to the tax consolidation rules.

The Australian Taxation Office faced a challenging year with media attention focused on Operation Elbrus (a PAYG fraud case) as well as technology issues. The Commissioner was reappointed until 2024, and the ATO released new tax gap information on large corporate groups. The ATO also publicly confirmed its early involvement in investigating the contents of the Paradise Papers.

The tax landscape has changed dramatically in a short time. This evolution will continue apace in 2018, with some of the key developments:

- Management of an increasing backlog of announced but unenacted taxation measures, and expected release of the Black Economy Taskforce report;
- The continuation of the BEPS journey; and
- The ongoing reinvention of the ATO with justified trust guiding a new taxpayer engagement approach increasingly underpinned by data.

2017 was a tumultuous year in politics

What’s in the pipeline for 2018?

In late 2013 concern was mounting over a backlog of 92 announced but unenacted tax measures; so-called ABUMs.

The newly elected Abbott Government sought to take action, making “go” and “no-go” decisions on various matters (37 measures would proceed).

Four years on, 32 of the 37 chosen measures have now been enacted or abandoned however some TOFA, debt equity and tax consolidation measures remain in the too hard basket.

To compound the issue, since the 2013 election, additional new tax-related announcements have started to accumulate.

As 2018 commences, the Government faces the need to guide over 30 tax-related post-2013 election measures through an uncertain Parliament, whilst also managing the remaining pre-2013 election measures.

A list of significant outstanding announced measures at the beginning of 2018 is in the Appendix.

In addition to the announced Government proposals, there are also a number of older Board of Taxation (BoT) recommendations to which the Government has not yet responded. Added to this are new BoT projects in the pipeline which include:

- High wealth individuals and residency
- Income tax treatment of bare trusts
- Alignment of tax and accounting concepts
- Review of taxation of earnout arrangements

A significant focus in 2018 will be the Black Economy: the Black Economy Taskforce report was handed to the Government in late 2017, and is expected to inform Government announcements in 2018. The impact of this report is likely to go far beyond the cash economy, and will likely impact businesses large and small.

Further, in late 2017 the Commissioner started to signal ATO concerns with the over-claiming of work related expenses, stating that although small in each case, the potential underpaid tax is significant.

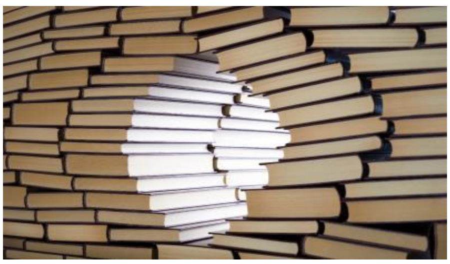
The ATO has subsequently convened a work-related expenses working group to co-design and implement relevant strategies. The ATO has also signalled increased compliance action in respect of undeclared income, unexplained wealth or lifestyle, small business expenses, unpaid superannuation guarantee contributions, and cash-only businesses.

A round-up of other expected tax-related developments include:

- The review of stapled structures which, in the Government’s view, is intertwined with affordable housing, and managed trusts issues
- Recommendations resulting from the early 2017 Treasury consultation paper on increasing transparency of the beneficial ownership of companies
- The release of Treasury’s final report of options to address the design issues identified in the PRRT Review, delivered to the Government in September 2017
- A government response to the recent Productivity Commission report on productivity (‘Shifting the dial’)
- A government response to the Review of the R&D Tax Incentive, publicly released in late 2016. This response is likely to be combined with the governments view on the 2030 Strategic Plan for the Australian Innovation Science and Research System that was also handed to the Government in late 2017

Meanwhile, the Senate inquiry into corporate tax avoidance will continue: now expected to report in May 2018.

A significant number of announced post 2013 tax measures have started to accumulate



BEPS: The journey continues

We consider that the three dominant themes in the 2018 BEPS journey will be:

- Australian implementation of various BEPS measures;
- Developments in the taxation of the digital economy; and
- Global responses to US tax reform

Much has already happened in terms of Australian BEPS implementation: signing the OECD Multilateral Instrument (Action 15), adoption of the updated OECD transfer pricing guidelines (Actions 8-10), implementation of the Multinational Anti Avoidance Law (MAAL), commencement of Country by Country reporting, legislation of the Diverted Profits Tax, and the release of anti-hybrid exposure draft legislation, amongst other developments. The ATO also strongly affirmed the success of the MAAL, reporting that it enabled the ATO to lock in future tax collections.

What can we expect in 2018? 2018 will see the first lodgement of CbC reports (Action 13) and, GST will be imposed on the offshore supply of intangible products to Australian consumers (Action 1).

The DPT, and the threat of the DPT, will start to influence ATO actions and taxpayer behaviours. The anti-hybrid measures will move towards finalisation, including development of a targeted integrity rule, that goes beyond the scope of the OECD BEPS recommendations.

We expect that Australia and other countries will start to ratify the Multilateral Instrument, and in turn, the treaty impacts could start to take effect in 2019. The interpretation of the Principal Purpose Test (PPT) is a key area to watch.

In terms of interest deductions, an interesting development "across the ditch" was the move away from the arm's length principle and towards global formulary apportionment. New Zealand introduced a rule that will limit the rate of interest on inbound related-party loans to more closely reflect the parent's credit rating.

At a global level, the taxation of the digital economy will be a focus in 2018. The OECD work so far on Action 1 has been considered underwhelming. The G20 remains concerned at the lack of a comprehensive and cohesive response to the digital economy. The OECD has accelerated its work and we can expect an interim report in April 2018. Meanwhile, we have already seen a proliferation of breakout measures:

- The UK announced a review of the tax challenges posed by the digital economy, and proposed a novel extension of UK royalty withholding tax.
- India has led the way with an "equalisation levy" which is being emulated by other countries.

In a remarkable demonstration of a truncated tax reform process, the US legislated major tax reforms which will reshape the tax preferences and commercial operations of US based multinationals. Whilst it is still too early to determine the impacts of US tax reform, it is fair to say that the ripple effect will be long and large.

In response to various global and US developments so far, we have seen major announcements by Facebook (moving to a local selling model) and Apple (accelerated US investment and job creation).

Multinationals can be expected to evolve their structures and operations to meet the laws and expectations of the new landscape. Governments and tax authorities will also continue to balance the fine line between attracting jobs and growth, and assuring the revenue.

Multinationals, Governments and tax authorities will continue to evolve to a fast changing tax landscape

ATO: Reinvented and busy

The ATO's metamorphis under its reinvention program is showing on a number of fronts: taking a harder line on perceived aggressive tax positions, challenging market practice positions, adopting a justified trust approach to taxpayer engagement, undertaking a more selective and successful litigation strategy, and increasing reliance on data gathering and data analytics.

Funding of the ATO Tax Avoidance Taskforce remains in place, with plans for additional recruitment in 2018.

The Commissioner, when asked last year about what the Government needs to do on multinational taxation, commented:

> *"I think we've got it about right. We've got the MAAL, we've got the DPT, we've got the expanded transfer pricing – which hasn't been fully tested yet—and we've got a stronger Part IVA, which hasn't been fully tested."*

So it seems that the resources are available, and the tools are in the toolbox. 2018 will be a year where we can expect the ATO to look to make full use of the laws that have been introduced, and to continue to seek to influence taxpayer behavior through its justified trust reviews of the largest taxpayers.

The ATO will look to assure a large proportion of the corporate tax base via its Top 100 and Top 1,000 programs (broadly covering groups with turnovers in excess of $250 million).

The four key focus areas for the ATO in respect of its assurance reviews around justified trust are:

- Understand a taxpayer's tax governance framework
- Identify tax risks flagged to the market, for example, through Taxpayer Alerts, Practical Compliance Guidelines, or Public Rulings
- Understand business activities, particularly significant and new transactions
- Understand why the accounting and tax results vary

These reviews will be supported by a wealth of additional information: for example, from Country by Country reports and from the rollout of the expanded scope Reportable Tax Position (RTP) schedule (requiring companies to self report tax risks).

For corporates, the 4 point justified trust inquiry lines together with the disclosures required in the RTP schedules provides a clear direction of the scope of work that taxpayers need to do in order to be able to provide assurance internally to management and to prepare for engagement with the ATO.

Through various steps, the ATO is continuing to move to a more real time, proactive and aggressive approach to tax administration.

This approach includes some targeted ATO initiatives: for example, off the back of the recent Tech Mahindra case, the ATO has specifically approached taxpayers it has identified to be within scope of that decision.

On ATO guidance, business continues to await finalisation of the revised ruling on residency. This will be of particular importance to outbound Australian groups. In addition, it is understood that the ATO is looking to modernise its guidance on the definition of royalties, to ensure that the guidance sufficiently addresses new and emerging business models.

Amidst all of this activity, tax authorities and taxpayers are on the cusp of moving into a world that is increasingly digital, and that over time, will change how tax is assured and collected and how tax functions are resourced and managed.

the ATO is seeking to influence taxpayer behaviour through its justified trust approach

Appendix: ABUMs

The post-2013 policy announcements currently before Parliament include:

- Whistleblower protections (introduced into the Senate)
- Self-assessment of effective life of certain intangible assets (Senate)
- New similar business test to utilise prior year losses (Senate)
- Enshrining the objective of superannuation in legislation (Senate)
- Increase in Medicare levy (Senate)
- Progressive reduction in corporate tax rate for all companies by 2023-24 (HoR)
- Clarification of eligibility for lower corporate tax rate (HoR)
- Extending crowd-sourced funding rules to private companies (HoR)
- Junior mineral exploration incentive (HoR)

Exposure draft (ED) tax legislation has been released for consultation on the following measures:

- OECD anti-hybrid rules
- GST remitted directly on new constructions and subdivisions
- Tax consolidation amendments
- MITs and affordable housing
- Affordable housing CGT discount
- CGT main residence changes for foreign residents
- Corporate CIVs and Asian Regional Funds Passport
- Transparency of tax debt
- Some Black economy interim measures
- Debt equity amendments
- Superannuation taxation integrity measures – limited recourse borrowing arrangements and non-arms length arrangements.

In addition, Treasury consultation papers on the beneficial ownership of companies, a CIV non-resident WHT, and anti-phoenixing measures have previously been released.

Measures still not legislated from 2013 include:

- Debt-equity rules – clarification of the scope of integrity provision (s.974-80) (ED issued)
- Consolidation tax cost setting amendments (ED issued)
- TOFA – extending eligibility to functional currency rules
- TOFA — amendments to tax hedging rules
- TOFA — foreign currency regulations.

The following major announcements have had little or no public developments to date:

- Targeted anti-hybrid integrity and branch mismatch rules
- MAAL integrity amendments
- Small business CGT concession integrity measures
- Division 7A changes
- Clarification of IMR / MIT regimes
- Partnership CIVs
- Other TOFA simplification (with a delay in commencement announced)
- Extending super fund merger relief
- Islamic financing

As noted, the Government is also yet to respond to a number of other BoT recommendations, and Treasury or Productivity Commission discussion papers.

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