International Tax

Australia Tax Alert

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2015-16 federal budget: What does it mean for multinationals?

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Australia's 2015-16 federal budget was handed down on 12 May 2015. For business, the budget delivered mixed fortunes, with small business set to benefit from a number of proposed concessions, including a cut in the company tax rate from 30% to 28.5%. Multinationals, however, face a range of measures designed to address tax avoidance. This alert summarizes the key measures that would affect multinationals.

The progress of the OECD base erosion and profit shifting (BEPS) initiative has not stopped some countries taking fast-track action to preserve their tax bases. Australia is no exception, with the recent announcement of the formation of a joint working group with the UK to consider and develop initiatives in relation to diverted profits by multinational enterprises and an Australian Senate inquiry into corporate tax avoidance, thus setting the scene for a budget containing a raft of measures to combat tax avoidance by multinationals.

Tax avoidance by multinationals

As foreshadowed in an announcement by the Treasurer on 11 May 2015, draft legislation was released on a measure to specifically address tax avoidance by multinationals (for prior coverage, see the tax alert dated 11 May 2015). The government expects the measure to target approximately 30 companies, and if enacted, it is intended to apply to tax benefits obtained as from 1 January 2016.

The draft legislation would amend Australia's existing general anti-avoidance rules (GAAR) to "negate certain tax avoidance schemes used by multinational entities to artificially avoid the attribution of business profits to a permanent establishment (PE) in Australia." Importantly, under Australia's tax laws, the GAAR generally takes precedence over Australia's tax treaties. The introduction of the measure by amending the GAAR presumably would be intended to counter the treaty-based argument that a multinational does not have a PE in Australia, and so should not be liable to Australian tax on business profits.

In broad terms, the measure would apply to a scheme where:

- A nonresident entity derives income from the making of a supply of goods or services to unrelated Australian customers;

- A dependent entity undertakes activities in Australia in connection with that supply; and
- The supply is not attributed to a PE in Australia.

The scheme also would need to satisfy two limbs of a purpose test:

- It would have to be designed to avoid the nonresident having a PE in Australia; and
- A principal purpose would have to be to enable a taxpayer (the nonresident or another entity) to obtain an Australian "tax benefit," or an Australian tax benefit and a reduction in foreign taxes or other Australian taxes (i.e. non-income tax).

To reduce compliance costs and provide certainty, the measure would apply only to a nonresident that has annual global revenue exceeding AUD 1 billion in the relevant income year in which it sought to obtain a tax benefit under the scheme. Furthermore, the measure would apply only where the nonresident is connected with a no or low tax jurisdiction. This would be the case if the nonresident or any other member of its global group conducts any activities that give rise to income that is subject to no tax or a low rate of tax by virtue of a law of a foreign country or an arrangement with the government or an authority of a foreign country, or if the income is "stateless income," i.e. not subject to tax in any country. While it is likely that many multinational groups would have some income subject to low or no tax, there are two "carve-outs":

- Where the activities generating the no or low-taxed income are not related directly or indirectly to the supplies by the nonresident to Australian customers; or
- Where the entity undertaking the activities undertakes substantial economic activity in the no or low-taxed jurisdiction.

These exceptions would apply if the Commissioner of Taxation is provided with sufficient information to conclude that the exceptions apply, which would require substantial analysis of the global supply chain and full disclosure of that information to the Australian tax authorities.

Where the anti-avoidance measure applies, the Commissioner effectively would be able to look through the scheme and apply Australian tax law as if the nonresident had been making the supplies through an Australian PE. As a result, there would be a number of consequences under Australian tax law:

- The nonresident would be subject to Australian income tax on business profits that would have been attributable to the deemed PE.
- Interest and royalty payments made by the nonresident that are attributable to the deemed Australian PE would be subject to Australian withholding tax. (Australia levies relatively high withholding tax, even under its tax treaties, so this consequential effect could be costly.)
- In addition to the recovery of unpaid taxes, interest and draconian penalties may be imposed (see below for proposed changes to the penalties).

New transfer pricing documentation standards

In addition to the proposed multinational tax anti-avoidance measure, the government is proposing to implement the OECD's new transfer pricing documentation standards as from 1 January 2016 (BEPS Action 13). Under the documentation standards, the Australian Taxation Office (ATO) would receive the following information on large companies that operate in Australia:

- A country-by-country report showing information on the global activities of the multinational, including the location of its income and taxes paid;
- A master file containing an overview of the multinational's global business, its organizational structure and its transfer pricing policies; and
- A local file that provides detailed information about the local taxpayer's intercompany transactions.

These reports would provide the ATO with a global picture of how multinationals operate, with a view to helping the ATO identify multinational tax avoidance.

This measure would apply to companies with global revenue of AUD 1 billion or more.

Enhanced penalties for multinational tax avoidance

The government proposes to double the maximum administrative penalties that may be applied by the ATO to large companies (i.e. companies with global revenue of AUD 1 billion or more) that enter into tax avoidance and profit shifting schemes. The aim of this change would be to deter tax avoidance, and would apply to income years commencing on or after 1 July 2015. Penalties would not change for taxpayers that have a "reasonably arguable" tax position.

Alignment with BEPS

Not content to wait for global agreement on the OECD's BEPS Action Plan, the Australian government is proposing to commence implementation of the key actions. The anti-avoidance measure targeting multinationals is aligned with Action 7 on PEs, the announcement on country-by-country and transfer pricing reporting implements Action 13, and the goods and services tax (GST) announcement (discussed below) is connected with Action 1 (digital economy).

Actions also were announced in respect of the following:

- Action 6 (Treaty abuse): Australia already includes some limited anti-abuse rules in its tax treaties. The government is proposing to act now to incorporate the OECD's recommendations into its treaty practice (e.g. incorporating limitation on benefits and anti-abuse provisions).
- Action 2 (Anti-hybrid rules): The government has requested the Board of Taxation to consult on the implementation of anti-hybrid rules. These rules would target the use of hybrid instruments or entities, for example, to generate deductions in two countries, or a deduction in one country with no corresponding income in the other country.
- Action 5 (Harmful tax practices): Some countries provide preferential tax deals to multinationals to attract their business, which may be harmful to other countries. The OECD has found that Australia does not engage in any harmful tax practices. Accordingly, the focus will be on the ATO exchanging information on secret tax deals provided to multinationals by other countries that may contribute to tax avoidance in Australia. This process already has commenced.

GST on intangible supplies

The government confirmed the release of exposure draft legislation that would apply Australia's GST to a broad range of intangibles supplied from outside Australia. Broadly, this measure would seek to impose GST on intangible supplies made to Australian "private" consumers by offshore businesses. In many cases, such transactions currently do not attract GST (10%). The intention of the measure is to create a level playing field between Australian and offshore suppliers of intangibles.

The proposed measures would not be limited to supplies of digital products (such as e-books, games, movies or music), but would encompass supplies of services, rights and intellectual property.

If enacted, the measure would apply as from 1 July 2017.

Comments

The key takeaway for multinationals from the 2015-16 federal budget is the clear message from the Australian government that action will be taken on multinationals that exploit loopholes and artificially structure to divert profits from Australia. To that end, the measures proposed would seek to equip the ATO with the means to effectively target, tax and penalize those multinationals. Further, Australia has shown a strong commitment to implementing the OECD's BEPS actions in a swift and decisive manner.