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International Tax

Australia Tax Alert

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Budget includes new DPT and BEPS rules

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Australia's federal budget 2016-17, announced on 3 May 2016, contains some very significant changes that would affect multinationals with Australian subsidiaries, including the introduction of a diverted profits tax (DPT) and anti-hybrid measures and the implementation of the OECD transfer pricing recommendations under the base erosion and profit shifting (BEPS) initiative.

The combination of the BEPS program, the Australian government's inquiry into corporate tax avoidance, a very public tax reform debate and intense media interest has resulted in a changed expectation of multinationals in relation to transparency and tax planning, and an increased community expectation for regulators to take a harder line in dealing with tax avoidance.

The government has strongly supported the international developments through its leadership of the G20 and via the OECD BEPS agenda. In addition, Australia has moved on a number of fronts in recent years, including new transfer pricing rules, tightening the thin capitalization rules and, most recently, introducing the Multinational Anti-Avoidance Law (MAAL) (for prior coverage, see the *World Tax Advisor* article dated 11 December 2015).

Diverted profits tax

When then-Treasurer Hockey met with the UK Chancellor in Washington, DC in April 2015 to announce "the urgent establishment of a joint working group to further consider and develop initiatives in relation to diverted profits by multinational enterprises," that set in motion the process that led to the MAAL, which is similar to the first limb of the UK DPT (for prior coverage, see the alert dated 11 May 2015).

This year's budget extends the focus on diverted profits by including a measure based on the second limb of the UK DPT. The government has released a consultation paper and is seeking submissions by 17 June 2016.

The Australian DPT would commence on 1 July 2017 and would be a tax applicable to significant global entities (turnover of AUD 1 billion or more) that use artificial or contrived arrangements to reduce tax by diverting profits offshore. The Australian DPT would:

- Impose a 40% tax on profits transferred offshore through related party transactions with insufficient economic substance that reduce the tax paid

on the profits generated in Australia by more than 20%;
- Apply where it is reasonable for the Australian Taxation Office (ATO) to conclude, based on the available information, that the arrangement is designed to secure a tax reduction;
- Provide the ATO with more options to reconstruct the alternative arrangement on which to assess the diverted profits;
- Impose a liability when the ATO determines that the DPT applies;
- Require upfront payment of any provisional DPT liability, which could be adjusted only following a successful review of the assessment; and
- Place the burden on taxpayers to provide relevant and timely information on offshore related-party transactions to demonstrate why the DPT should not apply.

The DPT builds on Australia's existing measures, including strong transfer pricing rules. It is expected that it would increase compliance by multinationals, encourage greater openness with the ATO, address information asymmetries and allow for speedier dispute resolution.

Combined, the MAAL and the DPT are expected to raise around AUD 650 million in tax revenue over four years.

Anti-hybrid rules

In May 2015, the government announced that the Board of Taxation (BOT) would consult on the implementation of anti-hybrid rules in accordance with the OECD's recommendations under action 2 of the BEPS project. The terms of reference included a request that the BOT report to the government by March 2016 "to allow this issue to be considered as part of the 2016 Budget." The government now has released the BOT report and confirmed that Australia will introduce anti-hybrid rules, modelled on the OECD BEPS recommendations, with effect from the later of 1 January 2018 or six months after the legislation is passed.

Australia is one of the first wave of countries adopting anti-hybrid rules. Taxpayers in Australia will need to continue to monitor the changing legislative framework of countries in which they do business to accurately assess how Australia's rules will interact with those of foreign jurisdictions, and the related impact on the tax outcomes arising under their financing arrangements.

The proposed rules are expected to affect the tax outcomes arising from a number of commonly used financing approaches in Australia. Taxpayers should consider the potential application of the rules to their financing structures and the associated tax, financial reporting, legal and treasury issues that may arise—including the potential need to refinance existing structures. The BOT report also notes the potential for Australia's general anti-avoidance rule (Part IVA) to apply to "artificial or contrived" replacement structures.

Transfer pricing

The government would amend the tax legislation to ensure Australia's transfer pricing rules are consistent with the new OECD guidelines arising from the BEPS project, with effect from 1 July 2016. The government notes that the "new rules will make clearer how intellectual property and other intangibles can be priced and that it is the substance rather than the contractual form of a transaction that forms the basis of taxable activity."

Other anti-avoidance proposals

- The government wants to improve disclosure of taxpayer information to the ATO, and would develop new rules requiring tax and financial advisors to report potentially aggressive tax planning schemes. A treasury discussion paper called “OECD proposals for mandatory disclosure of tax information” has been released, with submissions due by 15 July 2016.
- A range of maximum penalties would be increased for groups with global income of AUD 1 billion or more (significant global entities), including penalties for failing to timely file tax returns, business activity statements, country-by-country reports and similar tax documents. The new penalties could be up to AUD 450,000 and would apply as from 1 July 2017. The quantum of these penalties represents an increase by a factor of 100 to the previous rules. Penalties for false and misleading statements made to the ATO also would be doubled. These new penalties would send a clear message that the government will not tolerate inaccurate or delayed tax reporting.
- As from 1 July 2018, new whistleblower protections would apply to persons who disclose information about tax misconduct to the ATO. The new arrangements would protect tax whistleblowers against identity disclosure, victimization and civil and criminal action for disclosing information.
- The government has released further details on a new tax avoidance taskforce. The new taskforce was first announced on 3 February 2016, with the aim to reassure the Australian public that “businesses operating in Australia are paying their fair share of tax on the economic activity taking place in Australia.” Among other things, the new taskforce would play a critical role in implementing the BEPS recommendations and would provide regular progress reports to the government. The taskforce is expected to provide international leadership in its approach to cracking down on multinational tax avoidance. It is expected that the new specialized officers would possess expanded skillsets to fully exploit the significant levels of information and data available to the ATO.

Other measures affecting companies

Corporate tax rate reduction: The budget outlines a “10-year enterprise tax plan to support jobs and growth,” a key component of which would be a reduction in the company tax rate, moving to a 25% rate for all companies by 2026-27.

Currently, the company tax rate is 28.5% for companies with a turnover of less than AUD 2 million, and 30% for all other companies. The 10-year plan involves progressively raising the turnover threshold for companies to benefit from the reduced company tax rate, while also reducing the rates (applicable to companies above and below the threshold) over time.

The government notes that Australia currently has the seventh-highest company tax rate of the 34 OECD countries, and a rate that is much higher than neighboring Asian countries. The intention is for Australia to move to the “middle of the pack” on company tax rates. Although the 10-year plan is somewhat complex in its implementation, the trend to a lower tax rate is to be encouraged. However, it should be noted that many countries with which Australia is competing on the global stage already have a company tax rate lower than 25%,

and this downward global trend is expected to continue, while significant changes to the Australian rate would not apply for the better part of a decade.

Voluntary corporate disclosure code: The government has confirmed the final details of a new voluntary corporate tax disclosure code, based on the recommendations of the BOT (for prior coverage, see the *World Tax Advisor* "BEPS corner" item dated 24 July 2015).

As part of the 2015-16 budget, the Treasurer asked the BOT to develop a new voluntary code for greater public disclosure of tax information by businesses, particularly large businesses. As a result, the BOT issued a consultation paper on a *Voluntary Tax Transparency Code* on 11 December 2015. After consultation, the BOT issued its final report in February 2016, and the government now has released the BOT report.

The code would encourage businesses with an annual turnover of at least AUD 100 million to publish a range of tax information, including the Australian taxes they pay. The government encourages all companies to adopt the code as from the 2016 financial year.

Measures to promote the Australian funds management industry: New collective investment vehicle (CIV) structures would be created to attract foreign investors. A new corporate CIV would be available from 1 July 2017 that would allow Australian funds managers to offer investments through a company structure. From 1 July 2018, a limited partnership CIV also would be introduced (such vehicles commonly are used overseas to facilitate wholesale investment by large investors, such as pension funds). Creating these new structures should encourage foreign investment, as well as allow Australia to leverage off the existing strong funds management sector by exporting funds management services from Australia.

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