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General Manager
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The Treasury
Langton Crescent
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By electronic submission
http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2015/Tax-Integrity-Law

Dear Sirs

Submission on exposure draft Tax Laws Amendment (Tax Integrity Multinational Anti-avoidance Law) Bill 2015

We welcome the opportunity to comment on the captioned exposure draft legislation (**Bill**) and the associated draft explanatory material (**EM**).

We have enclosed our submission for your consideration.

If you have any questions regarding our submission, please contact Kenny Mui (on 02 8922 5490) or me.

Yours faithfully

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Tax integrity: multinational anti-avoidance law

Submission on exposure draft Tax Laws Amendment (Tax Integrity Multinational Anti-avoidance Law) Bill 2015

Executive summary

For the reasons set out below, we submit that the Bill should not be enacted and, at the very least, if it is to be introduced, broader consultation should be sought on the design and scope after the OECD's BEPS deliverables are implemented in the multilateral instrument[1] (**Multilateral Instrument**) at the end of 2016:

- enactment of the Bill as a unilateral measure is premature and would undermine the OECD's and its member countries' multilateral efforts. There will be inevitable overlaps and interactions between the Bill and the OECD's BEPS Action Plan. The OECD's work has not yet been finalised and is still undergoing changes which would not have been taken into account in the Bill and the EM. If the Bill and the EM are finalised and the Bill is enacted before the OECD finalises and implements its BEPS deliverables, the Bill and the EM will not take into account the OECD's ultimate recommendations. The relevance of the Bill after the OECD implements its BEPS recommendations and after Australia has considered the terms of its participation in the Multilateral Instrument would become questionable (see 1.1 below);

- it has been said that, "[a]s G20 President in 2014, Australia is fully supportive of the G20's commitment to a global response to BEPS based on sound tax policy principles".[2] The Australian Government should adhere to such statements supporting the drive for international consensus in the OECD / G20 project, and should respect Australia's long history of involvement with the OECD in its work of building and maintaining an international consensus on the principles of international taxation, to remain committed to developing an OECD consensus on tax reform as the basis on which to develop country specific legislation (see 1.2 below);

- enactment of the Bill, which will expressly override Australia's tax treaties, is highly inappropriate in the absence of any assessment of the revenue recoverable by the Treasury (see 1.3 below);

- ad hoc, unilateral initiatives developed outside of the OECD multilateral framework and timetable should not proceed, as it risks undermining the OECD's ongoing work to achieve agreement on a comprehensive multilateral framework.

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[1] OECD (2014), "Developing a Multilateral Instrument to Modify Bilateral Tax Treaties", OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing.

[2] S. Ciobo (Parliamentary Secretary to the Treasurer), "Addressing BEPS and the Government's policy agenda - Address to the Clayton Utz BEPS Workshop", 16 May 2014.

There is a risk that other countries will follow suit, resulting in an international tax landscape containing inconsistent and possibly contradictory rules that present the risk of different taxing jurisdictions pursuing tax liabilities over the same economic gain (see 1.4 below);

- the application date of 1 January 2016 would not allow sufficient time for many multinationals to take all necessary steps to restructure their affairs. Further, any necessary restructures should also take into account inappropriate behaviour set out in the OECD's BEPS Action Plan. Thus, the Bill should not apply at least until after the OECD finalises its recommendations and the Multilateral Instrument has been negotiated to incorporate those recommendations. If it were to be introduced, broader consultation should be sought on the design and scope of the Bill after Australia has decided the terms of its participation in the Multilateral Instrument at the end of 2016 (see 1.5 below);

- these provisions contradict a broad range of other initiatives specifically designed to encourage foreign companies to invest in Australia through tax rebates/refunds or lower effective taxes and sends a questionable message to foreign companies considering Australia as a location for staff or other regional operations. Specifically, the Bill effectively results in Australia imposing penalties on foreign companies (including those located in our main trading partners) where they fail to satisfy unique Australian standards - even if the foreign supplier is not considered by local country law to be avoiding tax or shifting profits to low tax paying jurisdictions. More generally, the amendments proposed in the Bill and underlying policy set out in the EM are inconsistent with the Australian Government's objective of attracting foreign multinationals to carry on business in Australia using Australian based employees and other resources. As specifically noted in the EM, companies that reduce or entirely eliminate their staff in Australia are more likely to fall outside the scope of these provisions (see 2 below);

- if the Bill is enacted, some longstanding commercial structures that had been implemented for genuine commercial reasons and in accordance with the law would need to be reorganised into less efficient commercial structures. This is so notwithstanding that the structures were implemented in accordance with the law, including the already stringent general anti-avoidance rules set out in Part IVA, and with the certainty of the Commissioner's specific endorsement in existing private rulings and advanced pricing arrangements. It would be difficult for taxpayers to seek certainty from the Commissioner on the validity of their structures under the Bill, given the limited timeframe due to the 1 January 2016 application date of the Bill and the current delays in the private ruling and advanced pricing arrangements due to the limited resources at the Australian Taxation Office (see 3 below);

- the Bill and the EM contain a number of anomalies that need to be addressed. The EM sets out an unacceptably broad concept of the non-resident being connected with a "low or no corporate income tax" jurisdiction. There is uncertainty on the level of disclosure required to substantiate that the "low or no" tax jurisdiction requirement is not triggered and its interaction with transfer pricing rules. Should the Bill be enacted, Australian domestic tax legislation will contain an unacceptable number of different purpose tests, with different purpose tests applying to different taxpayers, which is discriminatory in nature and would offend the principle of fairness. Also, it is uncertain how the doubled administrative penalties regime will apply to the amendments. Given the number of anomalies in the Bill and the EM and with the broader uncertainties pending the finalisation of the OECD's work on BEPS, the Bill should not be enacted and, if it is to be introduced, broader consultation should be sought on the design and scope after the completion of the negotiations over Australia's participation in the Multilateral Instrument to implement the BEPS proposals, which is scheduled for the end of 2016 (see 4 below).

Discussion

1. Appropriateness of a unilateral measure ahead of agreement on the OECD's multilateral framework

The Bill is Australia's unilateral measure to target BEPS, being proposed before the OECD finalises its multilateral framework and before OECD member countries implement the multilateral framework.

As explained below, the Bill should not be enacted until at least after the OECD implements the BEPS final recommendations and Australia has considered the terms of its participation in the Multilateral Instrument at the end of 2016.

1.1 Unilateral action is premature

If the Bill is enacted prematurely before the OECD finalises its multilateral framework, the Bill will undermine the collaborative efforts of the OECD, its member countries, the G20, and the associated economies engaged in the OECD/G20 BEPS project, in developing and finalising the OECD/G20's BEPS Action Plan.

The OECD has said that "unilateral action is much less efficient and effective than multilateral approaches" and it is their goal to "try to keep countries away from unilateral actions, especially before the action plan is completed".[3] The Treasury also has recognised the multilateral objective of OECD's work, one of which was to "help prevent individual countries putting in place damaging unilateral measures".[4] Further, the Treasurer has said that unilateral action by a particular country "is not going to do the job".[5]

There are many overlaps of concepts used in the Bill with the OECD's BEPS Action Plan deliverables. The non-attribution test and the designed purpose test in sections 177DA(1)(a)(ii) and 177DA(1)(b) target the avoidance of attribution of income to an "Australian permanent establishment", the term of which is defined by specific reference to the definition in Australian tax treaties, typically contained in Article 5 of the treaties and being examined in great detail in OECD's BEPS Actions 1 and 7. Those two tests also contain the concept of attributing income to an Australian PE, which overlaps with Article 7 of the treaties and the transfer pricing principles which are being examined in OECD's BEPS Actions 1, 8, 9 and 10. The no or low tax test in section 177DA(1)(e) targets non-residents' shifting Australian profits to low- or no-tax jurisdictions, which

[3] P. Saint-Amans (Director, Centre for Tax Policy and Administration), as quoted in the "Senate Economics References Committee - corporate tax avoidance", Official Committee Hansard, 9 April 2015, transcript at p61.
[4] S. Ciobo (Parliamentary Secretary to the Treasurer), "Addressing BEPS and the Government's policy agenda - Address to the Clayton Utz BEPS Workshop", 16 May 2014.
[5] See e.g. "G20 tax - joint press conference", Cairns, 20 September 2014.

overlaps with the concepts in OECD's BEPS Actions 1 and 4. The principal purpose test is also modelled on the same test proposed in OECD's BEPS Action 6.

Many of the concepts used by the proposed rules are still being considered and are yet to be finalised by the OECD. For example, the avoidance of an Australian PE as targeted by the non-attribution test and the designed purpose test may have very limited relevance after the OECD's BEPS Action 7 is finalised and implemented, since many structures that do not currently constitute a PE will constitute a PE after the OECD's BEPS Action 7 is finalised and implemented.

The Government should consider the interaction between the amendments and the OECD's BEPS Action Plans when the OECD's work is finalised - otherwise, there may be inconsistencies between Australia's unilateral measure and the OECD's multilateral framework. However, it would be currently difficult for the Government to consider the interaction, as the OECD's work is still being developed. For instance, the OECD's revised discussion papers for its BEPS Action deliverables 6 and 7 were released after the Government announced the proposed rules. Thus, the Bill and the EM would not have taken into account the multilateral developments recognised in those revised discussion papers.

Many of the BEPS final recommendations will be implemented through the Multilateral Instrument. Australia will have the opportunity to fully consider the terms of its participation in the Multilateral Instrument through the ratification process. More importantly, Australia will be able to secure agreement from its treaty partners to the same principles through this multilateral treaty. This approach will firmly establish Australia's response to BEPS concerns as part of an internationally agreed treaty, a far preferable approach to taxing cross-border transactions than unilateral action.

Given the inevitable overlap of tax issues sought to be covered by the Bill and the OECD's BEPS deliverables, implementation of the Bill without due regard to the OECD's multilateral framework, which is due to complete at the end of 2016, will place Australia out of step of the OECD's finalised position.

1.2 Departure from Australia's leadership role in developing consistent international tax policy

Unilateral action undermines the OECD's role as the international organisation which develops and maintains consensus on the principles of international taxation.

As an economy which has always emphasised its trading relationships around the world, Australia over the years has been a leading voice within the OECD in this work. The Treasury has said that "[a]s G20 President in 2014, Australia is fully supportive of the

G20's commitment to a global response to BEPS based on sound tax policy principles".[6] Many observers have noted that Australia's leadership role within the OECD has given Australia outsized influence in the past work of the OECD to develop and support an international tax consensus.

It will be ironic indeed if Australia now departs from its strongly stated commitments and becomes an active agent of the destruction of that consensus approach to international tax policy.

1.3 Inappropriateness of policy

The Bill will insert section 177DA as part of Part IVA of the *Income Tax Assessment Act 1936 (Cth)*, which specifically overrides Australia's tax treaties to the extent of inconsistency.

This means that, whilst a residence country would assert its taxing right on the basis that its resident taxpayer has no income attributable to an Australian permanent establishment (consistent with Articles 5 and 7 of tax treaties), Australia would still assert its taxing right under section 177DA on the basis that it specifically overrides any treaty relief.

This deliberate placement of section 177DA purposefully positions Australia to avoid its treaty obligations, giving rise to a taxing right that Australia would not otherwise have.

Despite the significance of the Bill, the Treasury has stated that the revenue recoverable is "unquantifiable"[7] and it has been reported that no costing was performed to assess revenue recoverable.[8]

It would be highly inappropriate for Australia to impose a unilateral measure that offends its treaty network and obligations, without any basic and essential assessment of the revenue impact.

1.4 Risk of double taxation and spread of unilateral actions

Unilateral measures will lead to risks of double taxation. "Stateless" income is an important example. Under the Bill, it is intended that Australia is asserting taxing rights on "stateless" income, the key focus of the "no or low tax" test in section 177DA(1)(e) (see EM at paragraph 1.27). Even if no other countries implement their own unilateral measures, Australia's taxation (as the source country) of "stateless" income of foreign residents would contradict other countries' taxation (as the residence country) of the same income. This will result in different revenue authorities asserting taxing rights on the same economic gain.

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[6] S. Ciobo (Parliamentary Secretary to the Treasurer), "Addressing BEPS and the Government's policy agenda - Address to the Clayton Utz BEPS Workshop", 16 May 2014.
[7] Treasury, Federal Budget 2015-16, Budget Measures, Budget Paper No. 2, at page 14.
[8] N. Khadem, "Abbott government's multinational tax avoidance plan was never costed", Australian Financial Review, 2 June 2015.

The problem escalates if other countries respond by also introducing and implementing unilateral measures which also depart from the accepted international principles defining nexus to tax and the attribution of profits to that taxable nexus. This creates a risk of uncoordinated unilateral measures imposed across different jurisdictions, resulting in a "multitude of unilateral measures which differ, duplicate or even contradict one another" that the OECD has specifically warned against.[9] The risk of such a turbulent international tax landscape can already been seen to be emerging, with UK (with its diverted profits tax) and China (with its Bulletin 16) introducing unilateral measures outside the OECD's multilateral framework.

1.5 Failure to achieve the intended outcome of behavioural change

The Bill is premised upon the intended outcome of taxpayers changing their commercial structures for sales into Australia. To the extent any taxpayers need to restructure their affairs so that they are no longer described in the proposed rules, these restructures will take a certain period of time to be assessed, planned and implemented. For instance, at the forefront of multinationals' decision-making processes, the restructure must not impede the commercial efficiencies and competitiveness of the multinationals' local, regional and global business. Taxpayers would also require certainty and thus require private binding ruling requests be made to the Commissioner on the tax consequences of the restructure and whether the restructure will satisfy the particular requirements of the Bill.

The application date of 1 January 2016 would not allow sufficient time for many multinationals to take all necessary steps to restructure their affairs.

Further, any necessary restructures will need to take into account changes to Australia's tax treaties to incorporate the final recommendations of the OECD's BEPS Action Plan. As the Multilateral Instrument will not be finalised until the end of 2016, taxpayers will not know how Australia's treaties will change until then.

Accordingly, the Bill should not apply at least until after the OECD finalises its recommendations and Australia has agreed to the terms of its participation in the Multilateral Instrument at the end of 2016. If it were to be introduced, broader consultation should be sought on the design and scope at that time.

2. Negative connotations for multinationals' activities in Australia

Many multinationals have carried on businesses in Australia through longstanding and established presences in Australia, for genuine business and commercial considerations. Proximity to local markets and product localisation are some of the key benefits obtained by a local presence in Australia.

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[9] P. Saint-Amans (Director, Centre for Tax Policy and Administration), untitled letter to Senate Economics Reference Committee, dated 18 February 2015.

Whilst the Government has previously acknowledged the importance of regional headquarters (**RHQs**) for multinationals' businesses, the Bill and the EM presents a number of negative connotations for multinationals' activities in Australia, much of which present risks of discouragement of investment in Australia.

2.1 Acknowledgement of the role of regional headquarters

It is important for the Government to acknowledge that RHQs of multinationals play an important role for multinational businesses. Multinationals, in particular businesses with annual global revenue in excess of A$1 billion, require RHQs to assist in the management of their global operations by reference to regional and local country characteristics. It is a genuine, commercial need.

There are obvious benefits in terms of physical proximity and time zone alignment. Also, RHQs serve as an important nexus between global and local markets, enabling businesses to coordinate the localisation of offerings while maintaining consistency with their global strategies. In addition, from an internal perspective of employee management, sensitivity to local customs can be key to ensuring a motivated and engaged workforce in the local jurisdiction such as Australia, providing additional job opportunities and economic prosperity in Australia.

The competition between governments to attract multinationals to set up RHQs is widely acknowledged. In the Australian context, the Government has publicly stated its policy to "to encourage multinational corporations to locate their RHQs in Australia" (Explanatory Memorandum to Taxation Laws Amendment Act (No. 3) 1994, at paragraphs 3.1 and 3.6). In more recent years, the Government has also enacted tax rules:

- that "will make Australia a more attractive location as a base for regional headquarters for overseas companies, as well as a continuing base for Australian multinational companies" (Explanatory Memorandum to the New International Tax Arrangements (Participation Exemption and Other Measures) Act 2004, at paragraph 4.2).

- "to further enhance Australia's status as an attractive place for business and investment" and "to overcome disincentives that exist for foreign residents to establish operations in Australia as a base for regional headquarter operations or to invest in Australian multinationals" (Explanatory Memorandum to the Tax Laws Amendment (2006 Measures No. 4) Act 2006, at paragraphs 4.124 and 4.148). This Act amended the CGT rules applicable to foreign residents, a measure that is said to "enhance Australia's status as an attractive place for business and investment by addressing the deterrent effect for foreign investors of Australia's current broad foreign resident CGT tax base" (the same Explanatory Memorandum, at paragraph 4.5).

- that "will improve the relative attractiveness of Australia as a destination for international capital" (Explanatory Memorandum to Tax Laws Amendment (2007 Measures No. 4) Act 2007, at paragraph 1.13).

These rules are intended to provide incentives to multinationals to establish RHQs in Australia, attracting foreign capital and investment into the Australian economy.

2.2 Discouragement of multinationals carrying on business in Australia

In contrast to the policy goal described above to attract multinational investment into Australia, the Bill and the EM contain strongly negative connotations on multinationals, their global commercial structure and their carrying on of a business and activities in Australia.

One effect of the amendments will be to discourage investment in Australia by multinationals. The EM at 1.57 specifically states that schemes are not caught by the amendments where the non-resident supplies goods or services through an independent agent or broker, or "without any Australian presence being integral to the supply". Put differently, the less substance an Australian subsidiary has, the less chance there is of an Australian taxable nexus. Multinationals commonly establish customer support organisations in subsidiaries in countries around the world, including Australia. The examples in the EM nevertheless establish that relatively routine customer support activities at the level of an Australian subsidiary constitute a level of substance that may result in Australian tax nexus for the subsidiary's parent. To mitigate this risk, multinationals may migrate their Australian sales and support functions out of Australia, leaving their Australian subsidiaries thinly staffed with low level employees.

This response would flow from the apparent policy foundation of the Bill - the Bill is a unilateral measure that penalises foreign enterprises' business activities in Australia that would not otherwise be taxable in Australia. Such overarching policy would be inconsistent with Australia's policy to facilitate and attract foreign capital into Australia and would present adverse connotations to the global business landscape as to the attractiveness of Australia as a business destination.

3. Existing private binding rulings and advanced pricing arrangements

The enactment of the Bill will put into question the continuing validity of a number of existing private binding rulings and advanced pricing arrangements, resulting in uncertainty for taxpayers and their investments in Australia. To maintain certainty for multinationals and their businesses, the Bill should contain a measure that excludes the application of the Bill to existing private binding rulings and advanced pricing arrangements.

Many taxpayers have longstanding commercial structures implemented to achieve commercial and business needs. Many of these structures were implemented with the certainty provided by the Commissioner as part of the private binding ruling and

advanced pricing arrangement systems, which play a crucial role in providing taxpayer confidence and certainty in the Australian tax system.

The Bill would cover a number of concepts for which taxpayers would have sought private binding rulings and advanced pricing arrangements in the past. Permanent establishment, income attribution and the arm's length nature of international transactions are important concepts on which taxpayers would have sought specific guidance and endorsement from the Commissioner.

If the Bill is enacted, many of these existing commercial structures will need to be considered in the context of the Bill. This is so notwithstanding that the structures were implemented in accordance with the law, including the already stringent general anti-avoidance rules set out in Part IVA, and with the certainty of the Commissioner's specific endorsement in private rulings and advanced pricing arrangements.

Should the Bill override existing private binding rulings and advanced pricing arrangements, taxpayers who wish to seek certainty again from the Commissioner on the validity of their structures under the Bill would face administrative and practical difficulties in doing so, given the limited timeframe due to the 1 January 2016 application date of the Bill and the current delays in the private ruling and advanced pricing arrangements due to the limited resources at the Australian Taxation Office.

Thus, to maintain certainty for multinationals and their businesses and taxpayers' confidence in the private ruling system and advanced pricing arrangements, the Bill should set out measures to continue to give effect to existing private rulings and advanced pricing arrangements. Given the focus of the Bill is on "complex, contrived and artificial schemes" (see e.g. EM at paragraph 1.10), arrangements that have already been endorsed by the Commissioner in private rulings and advanced pricing arrangements should not be affected by the Bill.

4. Anomalies in the Bill and the EM

If enacted in its current form, the Bill will present a number of uncertainties and inconsistencies that are likely to result in practical difficulties for taxpayers, the Australian Taxation Office and the courts in cases of disputes.

The Bill and the EM do not specify what constitutes a "low rate… corporate tax jurisdiction". Alarmingly, example 1.6 of the EM suggests that the "no or low" rate requirement is met even if a foreign country has a standard income tax rate that is not low or nil, but allows for a three year exemption from tax in limited circumstances. This is an unacceptably low threshold and, if the EM approach is followed in practice, many comprehensive corporate income tax systems of Australia's major trading partners will be treated as a low tax jurisdiction.

A clear example is Singapore. Singapore is one of the key financial centres in the Asia Pacific, with a sophisticated workforce, financial stability and sophisticated regulatory

regime. Multinationals have used Singapore as a regional hub after satisfying Singapore's local regulatory requirements. They may also limit the exposure of the Singaporean company to Australian contractual liabilities, by incorporating an Australian subsidiary to carry on Australian local operations, justified by reasons other than tax. However, once these two requirements are satisfied, there is a risk Singapore may be treated as a "low rate… corporate tax jurisdiction" solely because of its lower corporate tax rate than Australia's, or by reason of any concessions that are available to multinationals' regional headquarters established in Singapore. Under the proposed rules, the relevant Singapore company would be required to show to the Commissioner that the operations were not established for the principal purpose of obtaining a tax benefit in Australia or offshore or the tax concession available in Singapore do not breach what Australia considers is "low tax" or lacking substance. Appreciating the existing (and growing) focus of the Singapore Government on ensuring that these types of attributes are satisfied before domestic concessions are provided, it is questionable whether this approach is overreaching in terms of our relationships with our trading partners.

Also, the EM's articulation of how "substantial economic activity" exception is satisfied is overly broad, with example 1.8 requiring "thousands of highly valuable employees" - it is questionable how many multinationals would have thousands of highly valuable employees all across different regions of the globe. Further, neither the Bill and the EM set out the specific documentation requirements for the foreign resident to substantiate that the exceptions have been satisfied, with there being obvious overlaps with the existing transfer pricing rules and other proposed disclosure regimes.

If the rules are enacted in their current form, the general anti-avoidance rules will contain a multitude of four different standards: a general "dominant purpose" test, a section 177EA specific "purpose (whether or not the dominant purpose but not including an incidental purpose)" test, a section 177DA "designed" test and a section 177DA "principal purpose" test. Having four different purpose tests within the same set of rules will lead to a discriminatory treatment that applies different purpose thresholds to different taxpayers which would offend the principle of fairness, and would cause multiple layers of complexity for taxpayers, the Australian Taxation Office and courts in applying the tests in practice. The "designed" test is itself problematic, as seen from the difficulties observed in section 974-80 which uses the words "designed to operate", which still remains unresolved today. The "principal purpose" test is adopted from the "principal purposes" test that the OECD proposed in the context of Action 6 of the BEPS Action Plan. The origin of the Australian "principal purpose" test raises uncertainties as to whether and how such a test should be applied to Australian domestic law. First, the contexts in which the two tests apply are different, as the OECD's "principal purposes" test is a model for a treaty anti-abuse rule, not a model for a domestic law anti-abuse rule. Second, the two tests are worded differently. For instance, the OECD's proposed "principal purposes" test will not apply if granting treaty benefits would be in accordance with the object and purpose of the treaty, which is stated to be "to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax

evasion or avoidance"[10]. There is no such exception or stated purpose of avoiding double taxation in the "principal purpose" test in section 177DA, and it is therefore uncertain whether a court would impute this purpose from the OECD Commentary when applying section 177DA.

In addition, it is unclear how the doubled administrative penalty (applicable from 1 July 2015) applies only to the new anti-avoidance rule (applicable from 1 January 2016), and how do the two different dates interact in practice.

Given the number of anomalies in the Bill and the EM and with the broad uncertainties pending the finalisation of the OECD's work on BEPS, the Bill should not be enacted and, if it is to be introduced, broader consultation should be sought on the design and scope at the time the OECD's BEPS Action Plan is implemented in the Multilateral Instrument at the end of 2016.

[10] OECD (2014), "Preventing the Granting of Treaty Benefits in Inappropriate Circumstances - Action 6: 2014 Deliverable", OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, at paragraph 14.