Building a better
working world

Ernst & Young
8 Exhibition Street
Melbourne VIC 3000 Australia
GPO Box 67 Melbourne VIC 3001

Tel: +61 3 9288 8000
Fax: +61 3 8650 7777
ey.com/au

CORPORATE TAX
ASSOCIATION
of Australia Incorporated

General Manager
Law Design Practice
The Treasury
Langton Crescent
PARKES ACT 2600

15 June 2015

Via email: taxlawdesign@treasury.gov.au

Tax Integrity: Multinational Anti-avoidance Law – Exposure Draft

Dear Sir/Madam

Ernst & Young (**EY**) and the Corporate Tax Association (**CTA**) welcome the opportunity to provide our joint comments on the Exposure Draft of the Tax Laws Amendment (Tax Integrity Multinational Anti-avoidance Law) Bill 2015 (**Exposure Draft**).

Summary

Our key submissions are contained below. Further discussion on these matters can be found in the "Detail" section of this paper. In our view:

- Australia should not unilaterally legislate in relation to arrangements targeted by the Exposure Draft (**Targeted Arrangements**). Rather, Australia should move in step with the multilateral project being led by the Organisation for Economic Co-operation and Development (**OECD**) to counter Base Erosion and Profit Shifting (**BEPS**) (**BEPS Project**).
- Taking unilateral action to tackle a multilateral problem increases sovereign risk and undermines confidence in Australia's Double Tax Agreements (**DTAs**).
- If the Government pursues this unilateral action it should make a commitment to ensure that the legislation will be amended to align with the outcomes of the BEPS Project.
- The proposed legislation oversteps the announced policy intention and would be uncertain in its application. As such, there is the potential that it will impact a much larger range of multinational enterprises (**MNEs**) than the claimed targeted 30. We recommend that detailed examples of offending arrangements should be included in the Explanatory Memorandum to the Exposure Draft (**Explanatory Memorandum**) to ensure the legislative intent is more easily discernible.
- As discussed in Section 4 below, the proposed legislation requires significant refinement and clarification. Amongst the most important are:
    - There are several new terms that underpin the draft legislation that need to be defined and better explained. Significant uncertainty will be introduced in the application of the law if concepts like "low or no tax jurisdiction", "commercially dependent", "principal purpose" and "substantial economic activity" are not further clarified in both the legislation and the Explanatory Memorandum.
    - Taxpayers should not have to bear a burden to supply, and have the Commissioner of Taxation (**Commissioner**) accept, the information provided before their arrangements qualify for an exclusion from the rules. Instead, consistent with the self-assessment regime, taxpayers should have that information at hand to support their position should that position be subject to review by the Commissioner. If it is felt that the proposed

rules warrant a departure from accepted self-assessment principles, then greater clarity is required in relation to how/when taxpayers would meet the burden of proof in providing information to the Commissioner to justify that their arrangements are outside the scope of the proposed legislation.

- If the proposed law proceeds, the proposed start date should be deferred until at least 1 July 2017 to allow both the Commissioner time to develop guidance material as to the practical operation of the provisions to certain known fact patterns, and taxpayers sufficient time to determine if the rules will apply and consider options to restructure their business operations and take the necessary implementation steps. This also ensures that MNEs impacted by the Country by Country reporting requirements can factor in any such restructure in information to be provided to relevant Tax Authorities under this initiative.
- Alternatively, if the proposed law proceeds:
    - it should not apply to taxpayers with structures in place at the time of announcement of the proposed legislation unless those taxpayers fail to restructure or negotiate acceptable arrangements with the ATO by 1 July 2017; or
    - if that proposition is not accepted, penalties should not be imposed on taxpayers with structures in place at the time of announcement of the proposed legislation unless those taxpayers fail to restructure or negotiate acceptable arrangements with the ATO by 1 July 2017.
- Further guidance should generally be given on how the penalty provisions will apply (e.g. when remission will be appropriate and what will qualify as a Reasonably Arguable Position (**RAP**).
- It should be made clear through legislation or guidance that MNEs who restructure with the dominant purpose of not being caught within section 177DA should not be subject to Part IVA.
- The Exposure Draft appears to target a number of MNEs with US headquarters. Although certain profits may currently be recognised outside the US, any funds that are repatriated to the US to be paid out to shareholders could be subject to US tax. We submit that there should be clarity as to whether a compensating adjustment will be available to recognize that US tax will be paid at that future time. Further, we submit that the Government should seek to come to an agreement with the US Government that a foreign tax credit will be provided in the US in respect of amounts paid under section 177DA on repatriated profits.
- We note in that context that, as discussed above in section 1, there is a question as to whether tax paid under section 177DA (or amounts paid to the ATO under any Advanced Pricing Arrangement (**APA**) or deed of settlement or other arrangement discussed above) is tax paid 'in accordance' with a DTA. We submit that if the Government proceeds with enacting section 177DA, the ATO should contact other revenue authorities to confirm that foreign tax credits will be available.

Detail

We set out below our submissions in detail.

1. Targeted Arrangements should be dealt with in accordance with BEPS Project

It is disappointing that Australia is choosing to take unilateral action rather than await the outcome of the multilateral OECD BEPS Project. The proposed changes pre-empt the recommendations of the OECD BEPS Project which have been the subject of wide-ranging consultation. The Australian Government has been actively represented by the ATO and Treasury throughout this process. Their efforts, and Australia's role (as the G20 leader in 2014) leading the G20 adoption of the BEPS Project appear to be in direct contradiction to the adoption of the proposed legislation.

It is likely that the proposed section 177DA approach to issues of tax treaty misuse and avoidance of permanent establishment (**PE**) status will not be wholly in accordance with the recommendations that emerge from the BEPS Project Actions 6 and 7, and which the Australian Government is committed to support and enact as appropriate into domestic law. Australia needs to be, and needs to be seen to be, aligned with the outcomes of the BEPS Project. The proposed legislation raises the likelihood that we will have domestic law that is not consistent with the changes recommended under the multilateral response to BEPS and therefore Australia will need to amend or repeal this measure or be seen to repudiate the multilateral OECD BEPS approach to issues of the inappropriate application of DTA PE rules.

Specifically, it is unclear how section 177DA is proposed to interact with BEPS Action 7 (PE avoidance) and Action 6 (Treaty misuse). The OECD revised discussion draft on Action 7 (**Action 7 Revised Draft**) was publicly released three days after the Exposure Draft was released. Comments on the Action 7 Revised Draft were to be submitted by 12 June 2015 and the release of the final OECD paper outlining the consensus approach on Action Item 7 is due in October 2015. The differences between the approaches taken by the Exposure Draft (Australia's unilateral approach) compared to the Action 7 Revised Draft are set out in Appendix 1. Significantly, the Action 7 Revised Draft states that the OECD will continue to work on the issue of attribution of profits to PEs after September 2015, with a goal of providing guidance before the end of 2016, which is the deadline for the negotiation of the multilateral instrument that will implement the results of the work on Action 7. In other words:

- the OECD states that a critical piece of Action 7, the precise level of profits to attribute to the deemed PE that arises after the proposed changes to treaties, is still being discussed
- the consensus approach could be implemented with any number of treaty partners via multilateral instrument from 1 January 2017
- there is only a year between when section 177DA will commence to take effect, and when the outcome of Action 7 is finalized and indeed could potentially commence.

We see a need for clarity on whether the law will be adjusted or potentially replaced if the final BEPS Action 7 outcome is different to section 177DA. Potentially, the outcome for Action 6 may also be relevant, causing 177DA to be out of line. If the Government is determined to pursue unilateral action then it should make a commitment to ensure that section 177DA stays in line with the outcomes from the BEPS Project.

Submission: The proposed law, in its current form, is inconsistent with Australia's commitments to the OECD. If the proposed law is to be enacted, it must be in line with Australia's commitments to the OECD and so incorporate the outcomes from the BEPS Project.

2. Integrity of DTA system jeopardised

The proposed unilateral presentation of this draft law, given its potential breadth, is likely to undermine confidence in the integrity of Australia's DTAs and create uncertainty for foreign investment into Australia. In this regard, the OECD work on multilateral instruments ought to be completed in advance of the introduction of the proposed legislation.

Proposed section 177DA is contrary to the OECD principle of separate entity taxation that applies in respect of associated enterprises and has been agreed to and applied by Australia in its DTAs. It is unclear as to how the law will apply in relation to the interaction between deemed PEs and the operation of the arm's length principle in respect of existing related party transactions. The proposed tests provide that regard can be had to transactions to which no Australian taxpayer is a party. The proposed tests also enable a deeming of profit attributable to an Australian PE after taking into account transactions to which the relevant taxpayer may not be a party. The proposed tests purport to levy tax on a taxpayer without regard solely to the functions performed by the MNE in Australia, assets deployed in Australia or risks assumed by the MNE in Australia.
More specifically, looking at the DTAs in relation to global groups operating from countries with which Australia has DTAs:

- The proposed measure imposes new tests that are contrary to Australia's obligations under its various DTAs. The operation of section 177DA contemplates that tax could be payable where an MNE operates a business structure that complies with existing and operative DTA concepts of PE, within integrity measures agreed in such treaties (eg Limitation of Benefits), and which meets requirements for legal substance imposed by both contracting parties to the treaty. Where this occurs, taxes imposed under the new measure may not be 'in accordance with' the relevant DTA, and this may affect the ability for MNEs to obtain a foreign tax credit in the foreign jurisdiction for tax payable under section 177DA, or to obtain compensating adjustments that might otherwise be appropriate (for example under a business profits article or associated enterprise article).
- The proposed extension of Australia's taxing rights under Part IVA by section 177DA purports to tax income that is subject to the tax laws and taxing rights of a foreign country. For example, the reference to 'stateless income' (e.g. [1.27] and [1.40] in the Explanatory Memorandum) as it relates to US corporations is a reference to income that is only taxable in the United States. In respect of such income, US tax laws allow for deferral of such tax until it is repatriated, at which time US tax would be payable. Accordingly, taxation by Australia will effectively result in double taxation of this income once it is repatriated to the US, unless compensating adjustments under Part IVA are made as it is unlikely the US would grant foreign tax credit relief for taxes imposed under the new provisions.
- Within our DTAs, there are instances where Australia provides credits as tax incentives in circumstances where other countries provide lower tax rates or exemptions as incentives for substantial business investment (e.g. Article 18(3) of the Singapore Treaty). From a policy perspective, we submit that there is an inconsistency with respect to attacking structures that involve MNEs taking advantage of local country concessions in relation to real business activity. Every country has its own forms of tax concessions – for example, Australia has R&D concessions – but Australia is essentially seeking to limit the ability of other countries to provide tax concessions to attract business and investment where these are structured as exemptions rather than concessions.

Ultimately, from a policy perspective, there is an inconsistency in the messaging around foreign investment in Australia. Introducing laws that seek to tax profits of MNEs without regard to existing and accepted principles could have the effect of inbound MNEs seeking to reduce their Australian footprint. This is why the pursuit of a multilateral solution by way of participating and adhering to the OECD BEPS process is the more sensible and sustainable path. We submit the work on a multilateral instrument and

other BEPS measures need to be concluded first to ensure our domestic legislation is consistent with Australia's undertakings to the global community.

Submissions: The proposed law may undermine confidence in the integrity of Australia's DTAs and create uncertainty for foreign investment into Australia. In this regard, the OECD work on multilateral instruments ought to be completed in advance of the application of the proposed legislation. In the alternative, the proposed law should have a sunset clause inserted such that it only operates until such time as the revised changes to DTAs in relation to the definition of permanent establishment and treaty abuse proposed by the OECD are operative.

The law is excessive in its scope

The Government announcement on 11 May 2015 states that this "measure deals with the activities of 30 identified multinational companies". Further, [1.13] of the Explanatory Memorandum states that the proposed law "will target the most egregious tax structures by multinational entities, while limiting the impact on legitimate international business activities, to protect Australia's tax base". That is, there is a clear intention that the multinational anti-avoidance measures will have very limited scope.

However, the Exposure Draft in its current form has much broader application, albeit there are carve-outs. Given the nature of the proposed changes and the uncertainties embedded in the current draft, the proposed law will have the potential to impact a broad range of taxpayers, thereby creating an unjustified level of uncertainty.

We attach at Appendix 2 a number of examples of multinational entities that we see as potentially caught under the Exposure Draft. As businesses continually evolve in the global economy, it is likely that the proposed changes will impact many MNEs in the future. These examples show that the proposed law will likely apply to more than 30 multinational groups, and there has been insufficient development of the law to deal with common conventional international business arrangements. We outline below many unresolved issues of tax policy, of drafting and of administration as regards common international business scenarios, which make the law clearly not ready for adoption.

We consider that in some scenarios there might not be section 177DA issues as in many instances, having regard to the factors in section 177D(2) which are imported by section 177DA(2), the requisite principal purpose will be absent.

We submit that the proposed law demands an objects clause to clearly articulate its intent. This is critical because the current drafting of the law is extremely wide, and will as outlined below capture many foreign companies where the relevant support activities provided by associates (which then make them subject to the rules) are minimal in nature. Despite the narrowing of some concepts in the Explanatory Memorandum there is not such narrow scoping in the draft legislation.

Submission: The proposed law will have the potential to impact a broad range of taxpayers, thereby creating an unjustified level of uncertainty. The proposed law requires an objects clause and significant refinement to clearly articulate its limited scope.

3. Ambiguities in proposed legislation –section 177DA concepts need further policy development

We submit that there is a need to ensure that the legislation is sufficiently clear in what it is intended to do, to ensure that taxpayers are capable of complying with it with a reasonable outlay of time and cost.

Where a court regards the interpretation of a clause in section 177DA to be clear, **there will be no ability for that provision to be modified by reference to the Explanatory Memorandum or other guidance material** that is issued. Although we support the provision of additional guidance by the Government or the ATO (through the Explanatory Memorandum or other sources), we submit that this does not derogate from the need to ensure that section 177DA is clearly drafted in a way which provides certainty. Hence, we submit greater clarity is required in the words of the text used and the policy intent of the legislation be enshrined in an objects clause to clarify the intent of section 177DA and to identify that only a narrow group of taxpayers is expected to be affected.

3.1 'Associates'

To the extent that the reference to an 'associate' in sub-section (1)(a)(i) and (iv) is intended to be a reference to 'associate' as defined in section 318 of the *Income Tax Assessment Act 1936* (Cth) (**ITAA 1936**), we submit this should be clarified.

3.2 'Commercially dependent'

The term 'commercially dependent' in sub-section (1)(a)(iv) is not one that has previously been used in the income tax law, and it is unclear how far it is intended to extend. The Explanatory Memorandum to the Exposure Draft suggests that the requirement that the entity be an associate or commercially dependent on the non-resident "will ensure that the measure will not capture schemes where the entity undertaking activity in Australia genuinely constitutes an agent of independent status."

However, there will be many scenarios where an entity is arguably commercially dependent on a major customer, even though the agent is independent. For example, would an independent agent who receives 90% of their revenue or 60%, or 50% from a single foreign entity be 'commercially dependent' for the purposes of section 177DA?

We note that in the BEPS Project, the Proposed Commentary to paragraph 38.6 that was released as part of the Action 7 Revised Draft considers what it means for an entity to act "almost exclusively" for another entity. In that context, the Action 7 Revised Draft suggests that an entity acts "almost exclusively" when less than 10% of that entity's sales are for third parties. We submit that a statutory definition of 'commercially dependent' should be created, and that it should be aligned with the OECD views (i.e. 90+% of sales).

We note that even with this clarification, this terminology is susceptible to also picking up relationships such as those of certain independent distributors whose business is limited to one brand – for example, a car dealership. Arguably, these businesses are commercially dependent on the car manufacturer whose cars they sell, even though in practice they are third parties.

We submit that these types of relationships are clearly not contemplated to be caught within the '30 taxpayers' targeted by the Exposure Draft, and the definition of 'commercial dependence' should also exclude these types of relationships.

Submission: Greater clarity is required concerning the intended breadth of the definition "commercially dependent".

3.3 'In connection with the supply'

Section 177DA(1)(a)(iii) requires that activities are undertaken in Australia in connection with the supply by the non-resident.

The words "in connection with" are of extremely wide import. Further, there is very little direction as to the nature of the relationship required. As such, it is unclear whether there must be a direct causal connection or whether an inconsequential indirect connection is sufficient.

For example, assume a global multi-divisional business has an A-Products division which has an Australian subsidiary (A-Sub) (operating as a buy/sell reseller with full taxation on its activities). The global group has another foreign company in the B-Division (B-Co) which deals, from overseas, with unrelated Australian parties and asks A-Sub to provide some minor support activities:

- If A-Sub merely provides accounting services in Australia in relation to the supply does that attract section 177DA in relation to B-Co? We submit it should not and the law should clearly explain this.
- If A-Sub merely allows its office to be used for a visit every 6 months by a foreign executive of B-Co, it should not attract section 177DA.
- Alternatively, must the connection be directly related to the actual supply, for example, sales and marketing support or distribution support?

The activities of global businesses are necessarily interrelated so that at some level a connection could almost always be found between a supply and activities in Australia where the entity has an Australian presence. Accordingly, clarity is required on this point.

Submission: The law requires either the use of a more precise term, or the inclusion of a materiality threshold to overcome these fundamental concerns.

3.4 'Low rate' and 'corporate income tax'

Paragraph 177DA(1)(e) requires that the non-resident be "connected with" a "no or low tax jurisdiction". Sub-section 177DA(8) provides that a non-resident is connected with a no or low tax jurisdiction if the activities of the non-resident or other member of the global group "give rise to income that is … (a) subject to no corporate income tax, or a low rate of corporate income tax … or (b) is not subject to corporate income tax under any Australian law or foreign law".

There are a number of issues raised by sub-section (8):

- 'Low tax' is not defined in the Exposure Draft and it is unclear where the threshold is. Presumably, the policy concept of "low or no tax" would be better aligned to match with the OECD's work on harmful tax practices rather than using a different metric. As currently drafted there is significant ambiguity about where the line is. Would 20% qualify (i.e. the UK)? What about 17% (i.e. Singapore)? Or would a 12.5% tax rate (i.e. Ireland) be a 'low rate' of corporate income tax? We submit that, if there is to be a concept of "low or no tax" then there should be a legislative exclusion for any country with a headline rate of company tax at or above 10% so that it need not go through the additional process of demonstrating the activities mentioned in (10).
- Corporate income tax is not a defined term in the Exposure Draft, and it is unclear what this is intended to encompass. For example, would the UK corporation tax or capital gains tax constitute a 'corporate income tax'? We propose that the taxes covered by definition be imported from DTAs – i.e. if a tax is covered by a DTA that Australia has with the relevant country, then it should be taken into account as a corporate income tax.

- On a related issue, there may be jurisdictions where the income tax rate is low but there is a reasonably high level of tax on other bases which in Australia would generally not be regarded as an income tax (e.g. a resource rent tax and royalties). Would these other types of tax be included in the definition of 'corporate income tax' for the purposes of section 177DA?
- Subparagraph(8)(a)(ii) deals with arrangements with a government or authority of a foreign country or part of a foreign country – that is, it could include arrangements with a provincial government. In contrast, subparagraph (8)(a)(i) only considers a law of a foreign country, not a law of part of a foreign country. There may be instances where substantial tax is levied by a province, territory, state or canton of a foreign country. We submit that such tax should also be taken into account in determining whether the income is subject to no or low corporate income tax.
- It is unclear what the impact will be if the foreign tax rules change in a given year. If a country introduces a new tax concession or eliminates a tax concession during a year in which the arrangement has already been implemented, what is the effect? Will section 177DA be tested only at the time that the transaction is entered into; at the start of each income year; or at the end of each income year?
- Paragraph 177DA(8)(a) refers to income that is subject to no or low corporate income tax. Arguably, this provision would apply where an MNE has income in a country with a rate of corporate income tax which is not 'low tax', but the income of the MNE is subject to no corporate income tax in practice because it has tax losses or is able to access tax concessions (such as the equivalent to Australia's R&D concession). We submit that it would be inappropriate for section 177DA to apply to such taxpayers.
- In summary, it is unclear whether sub-section 177DA(8) is intended to apply to the headline rate of tax, a negotiated rate of tax or the actual tax paid or payable by a taxpayer. We submit that this should be clarified in the legislation.

These issues cannot be left to the ATO to administer without some clear policy direction on the approach to resolve those issues. In the absence of such policy direction the law cannot properly be introduced into the Parliament.

Submission: We submit that greater certainty is required concerning the definition of "low or no tax". In this regard, the policy concept of "low or no tax" would be better aligned to match with the OECD's work on harmful tax practices rather than using a different metric or limited to a headline income tax rate of less than 10%

3.5 'Principal purpose'

Paragraph 177DA(1)(c) creates a principal purpose test in relation to the tax benefit. This is not a test which has previously been used in Part IVA. In the Explanatory Memorandum, [1.70] suggests that 'principal purpose' has a meaning consistent with that used in the OECD context. To the extent that the intention is to adopt a particular international tax law meaning, we submit that it would be appropriate to insert that as a defined term into Part IVA and for there to be clearer expression of the concept in the Explanatory Memorandum. For example proposed paragraphs 63.1 and 63.2 of the "Revised discussion draft - BEPS Action 6: Prevent Treaty Abuse 22 May 2015 – 17 June 2015" might be considered for development.

Submission: We submit that the concept of "sole or dominant purpose" currently in Part IVA would have been a better threshold to apply. If a lower threshold is to apply to the application of the legislation, further definitional and explanatory clarity is required as to what will constitute a principal purpose.

3.6 Definitions relying on GST Act

The application of section 177DA requires that there be a supply by a non-resident to an Australian resident who is not an associate of the non-resident: subparagraph177DA(1)(a)(i). Supply is defined by reference to the meaning in section 9-10 of the *A New Tax System (Goods and Services Tax) Act 1999* (Cth) (**GST Act**). It is submitted that it is inappropriate to take definitions from other legislation as the legislation within which the defined term sits provides a whole framework that can affect interpretation and there can be unexpected implications for section 177DA if there is judicial consideration of the term in the GST context.

For example, section 9-10 of the GST Act states that:

(1) A supply is any form of supply whatsoever.

(2) Without limiting sub-section (1), supply includes any of these:

…

(f) A financial supply;

'Financial supply' in section 9-10(2)(f) is a defined term which is defined by reference to the A New Tax System (Goods and Services Tax) Regulations 1999 (Cth) (**GST Regulations**) made for the purposes of sub-section 40-5(2). Regulation 40-5.09(1) provides that the "provision, acquisition or disposal of an interest mentioned in subregulation (3) or (4) is a financial supply if … the supply is registered or required to be registered". That is, there are instances in which whether something constitutes a supply for the purposes of falling within section 177DA will depend on whether the non-resident is registered for GST.

Submission: We submit that the application of section 177DA should not turn on the interpretation of GST law.

3.7 A principal purpose of any person to benefit by reducing any foreign or Australian tax of any kind

Paragraph 177DA(1)(c) read with subsection 177DA(3) will taint an arrangement by looking to any person involved with that arrangement, and capturing any principal purpose (not dominant and not the only principal purpose) of such a person to reduce any tax.

So as listed in Appendix 1, if a person involved with an arrangement had a principal purpose of reducing an indirect tax (say a stamp duty, or a tax other than an income tax or a GST or VAT), then that will prima facie cause Section 177DA(1)(c) to be satisfied.

Sub-section 177DA(3) as drafted includes not only tax under a foreign law, but also tax under an Australian law (other than income tax). Subsection (8) limits (3) to be corporate income tax under Australian law, but (8) is stated to apply only "For the purposes of paragraph (1)(e)" and not to paragraph (1)(c).So a structuring feature to escape an Australian stamp duty or fire service levy would involve section 177DA in various circumstances. In effect, this extends the breadth of the general anti-avoidance provision in Part IVA to instances where there is no benefit from a foreign tax perspective, even though the intention of section 177DA is said to be limited to a small number of cases involving non-resident entities.

Submission: This drafting makes the policy intent unclear. It is imperative to have clarity so that the persons including the foreign resident supplier of the goods or services can resolve the position with the ATO, with sufficient considered administration measures in the law.

3.8 Ministerial power to amend section 177DA(2)

We submit that having regard to the nature of section 177DA as an integrity measure with a potential penalty of 100%, it is inappropriate that the Minister has the power under paragraph 177DA(2)(b) to change by legislative instrument the factors to which taxpayers are required to have regard in determining whether they are caught by sub-sections (1)(b) and (1)(c).

Any amendments to section 177DA, as with other provisions in Part IVA, should be subject to the normal legislative process.

3.9 Currency conversion for annual global revenue threshold

In determining whether a non-resident's annual global revenue under sub-section (1)(d) exceeds $1bn, sub-sections (5) and (6) direct attention to the audited consolidated financial statements or other financial statements for the non-resident. Sub-section (7) then provides that amounts under sub-sections (5) and (6) are to be expressed in Australian currency, and the conversion method must be based on the accounting standards.

It is unclear from sub-section (7) at what time the conversion must take place, and therefore at what time the foreign exchange rate to be used is determined. For example, does sub-section (7) require that each transaction entered into by the MNE be converted into Australian dollars at the relevant rate at the time of the transaction? If it is only the total revenue figure in the financial statement that is to be converted, is it to be converted at the rate applicable as at year end, at the time that section 177DA is applied, at an average rate over the relevant year of income, or based on some other measure?

Submission: We submit that there ought to be a simple and reasonable approach to currency conversions and this should be clarified in the legislation, possibly using the yearly average AUD to functional currency exchange rate for the relevant accounting period.

3.10 Substantial economic activity'

Sub-section 177DA(10) provides a carve out for taxpayers who undertake 'substantial economic activity' relating to the Australian supplies in the no/low tax jurisdiction. However, the Exposure Draft does not define 'substantial economic activity'. The Explanatory Memorandum gives one example 1.8 of substantial economic activity which outlines a situation where the non-resident entity "employs thousands of highly valuable employees who add significant value in relation to their Australian sales". This example does not give sufficient consideration to this important exclusion.

In our view:

- it is unrealistic for 'substantial economic activity' to be set by reference to a non-resident entity employing thousands of employees in a given jurisdiction, especially having regard to the fact that these provisions apply to a range of industries, some of which (e.g. technology or finance) are inherently not labour-intensive.
- The example focuses on the number of staff employed in a foreign country. Is 'substantial economic activity' limited to staffing, or will it cover other forms of economic activity such as plant and infrastructure or other assets in a foreign country? What about the business contracts that are entered into by the non-resident in that jurisdiction – for example, if the non-resident does not employ a lot of people, but uses a lot of contractors or otherwise outsources work in the foreign country? Scenarios such as these should be considered and addressed to avoid confusion.
- It is also unclear what constitutes adding 'significant value' – for example, is it based on the value of the goods/services that are provided by those employees as a proportion of the value for the Australian customer? Alternatively, is it based on whether those services are indispensable or

fundamental to the goods/services provided to the Australian customer? For example, the operation of a server in a low tax jurisdiction may be fundamental to the services provided to the Australian customer, but may not represent a large portion of the costs relating to the Australian supply – would that constitute 'substantial economic activity'?

- As mentioned earlier this should be tied in with the OECD materials being the Proposed Commentary to paragraph 38.6 that was released as part of the Action 7 avoidance of PE status. But again, as mentioned earlier, those materials are not finalised as yet.

Submission: We submit that there needs to a definition of 'substantial economic activity' with further examples of what substantial economic activity means and which factors which are relevant.

3.11 Burden of proof under sub-section 177DA(11)

The Explanatory Memorandum explains that sub-section 177DA(11) places the burden of proof on the non-resident to establish that the exceptions in sections 177DA(9) and (10) apply. In our view this purpose would be better served by a provision drafted similarly to that in sub-section 284-75(7) Schedule 1 of the *Taxation Administration Act 1953* (Cth) (**TAA 1953**), which states:

> If you wish to rely on sub-section (6), you bear an evidential burden in relation to paragraph (6)(b).

As drafted, sub-section (11) does not adequately identify the time or the type of information which is to be provided to the Commissioner. Arguably, the words "has not been given information" mean that if an entity is not proactive in providing information the Commissioner could assess on the basis of sub-section (11) not being satisfied without first making inquiries of the entity. In our view, this is inappropriate and ought at least to be amended so as to require that the taxpayer or non-resident entity be given notice of an intention to apply section 177DA and the opportunity to provide the information required by section 177DA(11).

Similarly, as drafted, sub-section (11) does not adequately identify the form in which information is to be provided to the Commissioner. Rather than amend sub-section (11) itself to specify this detail our recommendation is to adopt more general wording as to the burden, as suggested above, and to rely on the general powers to obtain information in section 264A of the ITAA 1936 and the TAA 1953 to require disclosure to the Commissioner. This also has the advantage of ensuring that the jurisdictional issues around requiring non-residents to act can be satisfied.

Further, if the provision of information is a precursor to obtaining the protection of sub-sections (8) and (9) the Commissioner should issue public guidance on what information would be expected to be collected and made available.

Submission: The provision needs to be amended to require that the non-resident bears the onus of proof to meet the exceptions in sub-sections (9) or (10) not that the Commissioner needs to be provided and accept information before the transaction qualifies for relief.

3.12 Tax benefit

We note that there is a lack of clarity as to the quantum of tax benefit which will be caught by section 177DA. Is the tax benefit calculated by reference to the profit that is made by the entity in the no/low tax jurisdiction that makes the supply to the Australian resident, or is there some other amount which comprises the tax benefit? We note that in a complex international supply chain there might be many value-creating activities of the foreign supplier of the goods or services, provided by many parties.

Submission: We submit that the Explanatory Memorandum should clarify what the proposed tax benefit would be in relation to section 177DA and the Targeted Arrangements. In particular, the Explanatory Memorandum should include at least one detailed example (including numbers) of how the tax benefit is proposed to be calculated.

Further, we note that sub-section 177DA(3) as drafted includes not only tax under a foreign law, but also tax under an Australian law (other than income tax). In effect, this extends the breadth of the general anti-avoidance provision in Part IVA to instances where there is no benefit from a foreign tax perspective, even though the intention of section 177DA is said to be limited to a small number of cases involving non-resident entities.

There is also no proportionality as to whether the tax benefit under section 177C has to be a material amount – that is, you could have a situation where a structure is regarded as having a principal purpose of obtaining a minor tax benefit and reducing a substantial foreign tax or Australian tax liability (not being income tax), and it would be caught under section 177DA.

We comment below, further, on the different commencement dates for the law to rectify the structural gap in Australia's GST law and for the section 177DA amendments.

3.13 Compensating adjustments as a result of tax paid in foreign country

Paragraph 177F(3)(d) of the ITAA 1936 allows the Commissioner to make a compensating adjustment where the Commissioner considers that an amount would have been allowed or allowable to the relevant taxpayer as a foreign income tax offset if the scheme had not been entered into or carried out. Although [1.88] of the Explanatory Memorandum refers to the Commissioner's ability to make a compensating adjustment, it is unclear when the Commissioner would reach the opinion that 'it is fair and reasonable to do so'.

Submission: We submit that to the extent that the relevant foreign jurisdiction is a 'low' tax jurisdiction such that the non-resident is paying some tax, the Explanatory Memorandum should clarify that the Commissioner will provide a foreign income tax offset for the amount of income tax payable in that jurisdiction.

4. If law proceeds, Targeted Arrangements should involve better interaction with the ATO and proper governance

The proposed law differs from the UK approach of a Diverted Profits Tax (**DPT**) but with more severe adverse consequences for affected groups:

- Imposition of an anti-avoidance rule; and
- Imposition of a 100% penalty plus further penalties for late payment.

Despite the harsh application the draft law does not comment in detail on the role of the ATO, the scope for discussion with the ATO by groups which want to resolve their position, and the governance around those processes.

This contrasts sharply with the UK DPT which was introduced with extensive mechanisms which include[1] a notification to the HMRC, a charging notice by an HMRC officer, and companies having opportunities to demonstrate the supportability of their position.

[1] [1] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/422184/Diverted_Profits_Tax.pdf

We do not seek identical processes. But there is a need to outline the processes for taxpayers to be exposed or, more relevantly, confirming they are not exposed to the tax, given its harsh implications.

5. The law and current ATO materials must provide certainty

5.1 Administrative processes to enable taxpayer certainty

There are MNEs who would fall out of section 177DA as a result of the carve outs in sub-section 177DA(9) (where MNE activity in a no/low tax jurisdiction is not directly or indirectly related to the Australian supply) and sub-section 177DA(10) (where there is substantial economic activity in the no/low tax jurisdiction in connection to the Australian supplies). However, having sub-section 177DA(11) requires on its current drafting that these entities are required to seek certainty through the rulings process or other engagement with the ATO.

Furthermore, certain MNEs who are required to report uncertain foreign tax positions under their home state laws (e.g. US listed entities are required to report under US Fin 48) will be required to consider whether section 177DA may apply to their arrangements, and if so, to make appropriate disclosures.

Thus, the proposed legislation potentially creates a compliance burden on a much larger subset of MNEs than intended.

The ATO needs to be prepared for MNEs approaching it to resolve their positions. This will include taxpayers seeking confirmation on the non-application of section 177DA and taxpayers seeking guidance on reorganisations to preclude section 177DA. This may be by private binding rulings or other means (e.g. general guidance). We note that traditionally the ATO has been reluctant to provide rulings on Part IVA. On this basis, clarity needs to be provided on how taxpayers can best engage proactively to obtain certainty as to their positions under section 177DA.

Having regard to this anticipated demand, the ATO's role and its expected administrative practice should be clearly set out in the EM to ensure there are no misperceptions of limited ATO powers after enactment. Further, the ATO needs to identify and assemble appropriate guidance on section 177DA urgently, including the mechanisms to be adopted by MNEs seeking certainty. We see a need for the ATO to issue guidance at the same time as legislation. This will be a challenge as we note that the ATO is yet to rewrite its guidance (e.g. PS LA 2005/24) on Part IVA since the legislation was last amended in 2012.

Submission: The ATO should produce written guidance on how it will apply the law and that guidance should be released at the time the new law applies.

5.2 Administrative arrangements for MNEs that have continuing Targeted Arrangements

Further, there may be instances where MNEs determine that their existing structures are likely to be subject to section 177DA, but will be commercially prejudiced if they change those arrangements and therefore decide that they will maintain the existing structures for commercial reasons. The MNE might consider that by recording the Targeted Arrangement as a PE in Australia and paying Australian tax then the preconditions for application of section 177DA will no longer be satisfied in Australia. But this raises the issue mentioned above of whether the foreign supplier will be eligible to claim foreign tax credits in its home jurisdiction in circumstances where the home jurisdiction, relying on long-standing international tax principles, might consider there is no PE in Australia. We submit that there needs to be a mechanism

for MNEs to pay the appropriate amount of tax on an annual basis in a way which does not prevent them from obtaining a foreign tax credit as appropriate for that tax.

Under section 177F of the ITAA 1936, the Commissioner can only issue a Part IVA determination where “a tax benefit has been obtained, or would but for this section be obtained”. That is, there is no power for the ATO to issue Part IVA determinations on a prospective basis. To the extent that MNEs continue with Targeted Arrangements, there needs to be an efficient way under Part IVA whereby the taxpayer can enter into a once-off arrangement with the ATO to ensure that the appropriate amount of tax (having regard to section 177DA) is paid.

We note, without detailed analysis, that an option which some MNEs might consider might be to increase the income generated by the Australian or related entity providing the support services, potentially involving an APA with the ATO which treats the appropriate amount as income for the Australian subsidiary, and taxes it at that level. If such a remediating option was available this might remove the tax benefit under section 177DA and therefore remove the risk of section 177DA applying. However, in our recent experience, the APA process will not move quickly enough, or be able to encompass a sufficiently broad range of taxpayers, to give certainty prior to 1 January 2016.

A further alternative may be that the taxpayer and ATO can negotiate a deed of settlement as to the application of section 177DA, including the mechanism whereby future years of tax are dealt with.

5.3 Notification of Targeted Arrangement to remove penalties

In each of the above cases, we submit that the Government or ATO should provide that where taxpayers notify the ATO prior to 1 January 2016 that they may have a Targeted Arrangement, penalties can be remitted if:

- the taxpayer subsequently restructures such that they fall outside section 177DA; or
- the taxpayer enters into an APA or other agreement (e.g. a deed of settlement) with the ATO for future years in relation to the amount that would be identified as a ‘tax benefit’ under section 177DA.

5.4 Provision of compensating adjustments or foreign tax credits by other countries

Finally, it is clear that the Exposure Draft is targeted at a number of MNEs with US headquarters. Although in some instances profits may currently be recognised outside the US, any funds that are repatriated to the US to be paid out to shareholders will be subject to US tax. We submit that there should be guidance provided as to whether there will be any compensating adjustment available at that time to recognize that US tax will be paid at that future time. Further, we submit that the Government should seek to come to an agreement with the US Government that a foreign tax credit will be provided in US in respect of amounts paid under section 177DA on repatriated profits.

We note in that context that, as discussed above in section 1, there is a question as to whether tax paid under section 177DA (or amounts paid to the ATO under any APA or deed of settlement or other arrangement discussed above) is tax paid ‘in accordance’ with a DTA. We submit that if the Government proceeds with enacting section 177DA, the ATO should contact other revenue authorities to confirm that foreign tax credits will be available.

5.5 Clarification that restructuring will not fall foul of Part IVA

Further, where MNEs restructure to be compliant with section 177DA, there is a risk that this very restructuring would be subject to the general provisions under Part IVA, in that they enter into a scheme, the dominant purpose of which is to avoid the imposition of tax under section 177DA. Such an outcome would be manifestly inappropriate, and it should be made clear through legislation or guidance that

MNEs who restructure with the dominant purpose of not being caught within section 177DA should not be subject to Part IVA.

6. If this law is to be introduced then the commencement date should revisited

We understand that the Government and ATO anticipate that MNEs will respond to section 177DA by restructuring their inter-group arrangements to avoid the application of section 177DA.

To the extent that section 177DA is intended to force MNEs to restructure their existing Australian arrangements, the proposed commencement date of 1 January 2016 does not give MNEs adequate time to review their existing structures, determine if there is a restructure that is possible that could mitigate the impact of the proposed rule change and is compatible with their existing global business, and to implement the necessary structural changes. It is also highly likely given the place of the Australian market for many inbound MNEs that a restructure may need to be considered in the context of the potential impact on subsidiaries in several jurisdictions.

To the extent that a restructure is required, MNEs are likely to need time to consider the merits of the restructure, the mechanics of the restructure and to obtain approval from relevant internal stakeholders (and potentially from external regulatory bodies) for restructure to take place. Further, it is likely that any restructure would require systems changes (which is likely to affect not just Australia but also a number of other jurisdictions) as well as renegotiation of existing contracts with third parties. All of these steps will take time. Given it is unlikely that this legislation will be enacted before August-September 2015, a 1 January 2016 start date is too short.

Consider these examples:

> A global food manufacturing and distribution business based in Europe licenses one of its brands to an unrelated Australian manufacturer. Some support services are provided by an onshore affiliate and the license is structured to not create an Australian PE. The arrangement is structured so that one objective of one party is to reduce stamp duties in a foreign jurisdiction. Based on the current words of the law a principal purpose by any person to obtain a tax benefit in relation to any tax under any foreign law can invoke the anti-avoidance rule with 100% penalty outcomes.
>
> A global engineering and manufacturing company sells engineering products from an overseas jurisdiction (foreign supplier) to Australian customers. It has an Australian subsidiary, or an offshore associate providing preparatory or auxiliary activities (which are compensated by fees which are taxable in Australia) but which do not give rise to a PE of the foreign supplier in Australia. The group first needs to understand if it is exposed under section 177DA based on the final law (August/September 2015). If so, then it might need to change its Australian supply chain to replace the existing Australian support services, which requires structuring analysis, changes to legal and operational arrangements possibly the creation of new entities, and possibly legal agreements. It might consider adjusting the fees paid to the Australian subsidiary or associate but that does not eliminate the tax risk to the foreign supplier. The foreign supplier will seek comfort from the ATO, but that requires ATO readiness and capacity to provide certainty. We do not see all of this being possible for all the affected companies by 1 January 2016.

To the extent that the proposed law remains retrospective, we submit that it would be appropriate to defer the start date for the application of section 177DA to 1 July 2017 to:

- give MNEs an opportunity to undertake all the steps necessary to implement a restructure;

- harmonise the start date to a greater extent with the start date for the GST expansion in relation to digital supplies to consumers. We note that the GST measure, covering not unrelated issues, was announced in the Budget but is to be effective for supplies starting from 1 July 2017. We assume that delay is to enable proper machinery and compliance issues to be developed. The same holds true, in our view, in relation to section 177DA;
- assist MNEs to ensure that any restructure arrangements will comply both with section 177DA, as well as any OECD Actions under the BEPS Project, in particular Action 7; and
- give the ATO more time to direct appropriate resources to being able to resolve taxpayer positions, provide guidance, and to align the resolution of section 177DA matters with ongoing tax audits as appropriate.

To this point, we see many aspects of the administration of the law that require significant time investment from both the ATO and taxpayers before the ATO can provide taxpayers with the requisite certainty when approached. For example:

- The rules contemplate that in order to discharge the primary burden of proof about substantial economic activities in the relevant foreign countries, taxpayers are to be required to provide information to the Commissioner in respect of the activities covered by section 177DA(8) – see section 177DA(11). Is the ATO ready to deal with such scenarios?
- How will the ATO determine the appropriate revenues to be attributed to the deemed Australian PE of the foreign supplier under section 177DA, if that was the resolution approach adopted by the foreign supplier?
- Has the ATO prepared its products to provide certainty to taxpayers about the non-application of the law to their circumstances? This requires ATO mechanisms – whether advance compliance arrangements, private binding rulings, advance pricing agreements or deeds – to be determined and formalized in ATO processes, then negotiated and written for individual groups' circumstances.

7. If commencement date is not extended, provision should be made for taxpayers, who have advised an intention to restructure, to be protected while they consider their position/restructure

If, notwithstanding the complexity, uncertainty and inefficiencies associated with the proposed legislation, the Government does not defer the general commencement date of 1 January 2016, we submit that taxpayers who notify the ATO by 1 January 2016 that they are intending to restructure and can show that they are unable to implement the necessary restructuring by 1 January 2016 (e.g. due to regulatory issues or the general complicated nature of their existing structures) should be given extra time to implement those restructures. The amount of extra time should be determined on a case by case basis to reflect the issues that preclude an immediate reorganisation.

8. Penalties

We understand that under the penalty provisions announced on 12 May 2015, there will be two penalty levels applicable under Part IVA (including section 177DA): 25% penalty where the taxpayer has a RAP and 100% penalty where the taxpayer does not have a RAP. We further understand that in assessing whether a RAP exists, regard is to be had to the existing principles in schedule 1 section 284-15 of the TAA 1953.

We submit that guidance is required on the way in which the RAP standard is to apply to section 177DA.

The Exposure Draft provides that section 177DA will apply to tax benefits obtained on or after 1 January 2016, but including schemes that are entered into or commenced before that date. Accordingly, there is the potential for section 177DA to apply to arrangements which MNEs have had in place for many years, and which form part of a MNE's underlying business structure.

Conflict arises in applying the RAP standard in this scenario. The RAP standard is based on the state of tax laws and authorities at the point in time when the transaction which results in the tax liability arises[2]. That is, the RAP for a taxpayer as at 1 January 2016 will need to be determined having regard to the presence of section 177DA. However, taxpayers potentially impacted by these proposals may have structures that have been in place for many years (e.g. 10-15-20 years). That the outcome may be unfair is particularly evident in the circumstance where the tax benefit is obtained on or after 1 January 2016 in connection with a scheme but because of an underlying business structure which was in place prior to the announcement or enactment of section 177DA. That section 177DA is also dependent on other factors outside of the taxpayer's control such as exchange rates which impact on global revenue and tax policies of foreign jurisdictions only adds to the potential for inequity.

Further, there are taxpayers with existing investment structures that have previously been reviewed by the Australian Taxation Office and in some cases have received favourable Private Binding Rulings in relation to the absence of a PE, tax audit sign offs, or have been party to APAs. We also understand that the ATO has signed off on some Australian-agency commission arrangements where Australian income is taxable. In this context it would clearly be inappropriate that the law should now be changed retrospectively to impose severe penalties on taxpayers in respect of these structures where the taxpayers have taken proactive action to seek confirmation from the ATO that they are compliant with the tax law.

Further, as discussed above, there will be instances where MNEs propose to restructure but are unable to do so in the time available before the proposed commencement date of 1 January 2016. Again, it would appear unconscionable that a taxpayer that is unable to restructure within a limited period of time is exposed not only to income tax, but significant penalties. That is a taxpayer that complies with existing law, will be exposed to penalties if it does nothing.

We also note that the disparity in penalty rates, being 75%, seems disproportionate to the severity of the wrongdoing where that difference is based only on whether or not a taxpayer has a reasonably arguable position, given that:

- whether or not there is a reasonably arguable position is an objective test and therefore may be satisfied by a taxpayer whether or not the taxpayer took steps to confirm their tax position;[3] and
- the existing penalty rate for intentional disregard, being known wrongdoing, is only 75%.[4]

Having regard to the above, we submit that to the extent that section 177DA commences on 1 January 2016, there should be a legislative provision grandfathering the schemes in relation to the imposition of scheme penalties at 50% rather than 100% in the absence of a RAP.

* * * * *

[2] See *Allen's Asphalt Staff Superannuation Fund v Commissioner of Taxation* [2011] FCAFC 188.
[3] See Allen's Asphalt Staff Superannuation Fund v Commissioner of Taxation [2011] FCAFC 188.
[4] See Allen's Asphalt Staff Superannuation Fund v Commissioner of Taxation [2011] FCAFC 188.

Thank you for providing us with the opportunity to provide a submission. If you have any queries or wish to discuss, please contact Michelle de Niese on mdeniese@corptax.com.au or 03 9600 4127, or Sue Williamson on sue.williamson@au.ey.com or 03 9288 8917.

Yours faithfully,

Michelle de Niese Executive Director Corporate Tax Association	Sue Williamson Partner | Tax and Law Ernst & Young

Appendix 1

Differences between Section 177DA and Action 7 Revised Draft

Table 1: Comparison of terminology used in new section 177DA ITAA 1936 and OECD BEPS Action Item 7 discussion draft.

Topic	Australian explanation and approach	OECD on Action Item 7
Application	On or after 1 January 2016 with no grandfathering for existing structures: Item 4 of Exposure Draft	Implementation from 31 December 2016 through multilateral instrument
Legislation	Exposure Draft	Revised Discussion Paper
Schemes captured	Any supply by non-resident to Australian non-associated resident: 177DA(1)(a)(i)	Focus on commissionaire-type arrangements
	Artificial PE avoidance (no profit attributed to PE): 177DA(1)(a)(ii)	Artificial PE avoidance (no profit attributed to PE)
	Activities undertaken: 177DA(1)(a)(iii)	A person acting on behalf of an enterprise habitually concludes or "negotiates the material elements" of certain contracts
	Activities undertaken through an Australian PE of an entity that is either an associate or is "commercially dependent": 177DA(1)(a)(iv)	"Associated enterprise" too broad – replaced with "connected to" test (defined by 50% voting rights or defector control)
	Activities undertaken through an Australian PE of an entity that is either an associate or is "commercially dependent": 177DA(1)(a)(iv)	Person acting almost exclusively for the connected enterprise – for example less than 10% of the agent's sales are for non-connected enterprises
Profit attribution to deemed PE	Profit to be attributed to deemed PE with no further guidance: 177DA(1)(b)	Profit attribution in line with global standard to be updated by 31 December 2016
Purpose	"Principal purpose" or "one of principal purposes" is to obtain a tax benefit: 177DA(1)(c)	Purpose not directly applicable. Strong reservations against PPT voiced as part of Action Item 6 voiced
Global Revenue	AUD $1 billion global revenue threshold: 177DA(1)(d), (5), (6) & (7)	No global revenue threshold
Schemes to be specifically listed	Scheme captured can be extended by legislative instrument: 177DA(2)	As defined by final guidance in October 2015 with likely strong focus on commissionaire arrangements
Tax Benefit	Tax benefit under Australian or foreign law: 177DA(3)	Attributing profit to PE under revised transfer pricing principles as agreed by December 2016
Self-executing provision	Not self-executing: requires Commissioner's determination to apply anti-avoidance rule. Treaty overlay with some question marks: 177DA(4)	Self-executing through normal self-assessment process. Mutual agreement adjustments under treaty where required
No or low corporate tax jurisdiction	Rules only apply in the context of income being subject to no or low corporate income tax rate: 177DA(8)	Not directly applicable (limited discussion in the context of Option M - dependent agents who do not formally conclude insurance contracts)
Exclusions	Income subject to low tax does not relate to Australian activity: 177DA(9)	Not directly applicable. However, auxiliary and preparatory activity in Australia, as modified, would continue to apply
	Entity undertakes substantial economic activity in the low tax rate jurisdiction:	Not directly applicable ("substantial" used in the context of physical

	177DA(10)	presence, time, and information provided)
Supply of information requirement	Exclusions in (9) and (10) taken not to apply in relation to the activity where FCT not given supporting information: 177DA(11)	Normal substantiation requirements as part of transfer pricing documentation.
Geographic Reach	Applies to schemes carried out in Australia and overseas: 177DA(12)	Schemes within the ambit of the relevant double tax treaty

Appendix 2

These scenarios illustrate the broad range of circumstances in which multinationals might be affected, to improve policy and develop guidance in this area:

- A global food manufacturing and distribution business based in Europe licenses one of its brand names to an unrelated Australian manufacturer. Some support services are provided by an offshore affiliate and the license is structured to not create an Australian PE. The arrangement is structured so that one objective of one party is to reduce stamp duties in a foreign jurisdiction. Based on the current words of the law a principal purpose by any person to obtain a tax benefit in relation to any tax under any foreign law can invoke the anti-avoidance rule with 100% penalty outcomes.

- In a foreign group restructure of its activities one aspect is to escape an Australian stamp duty or fire service levy. This appears to constitute a requisite tax avoidance purpose and would invoke section 177DA if the other conditions are satisfied.

- A global engineering and manufacturing company AlphaGlobal sells engineering products from one of its divisions, from Alpha-Division subsidiary in an overseas jurisdiction (ForeignAlpha {Pty) to Australian customers. The global business also has one or more significant activities in one of its other divisons - in its Beta and Delta Divisions – with Australian subsidiaries being AusBeta Pty Ltd and AusDelta Pty Ltd,. (Similar examples might arise with a large range of foreign entities supplying to unrelated parties in activities such as technology, engineering, design, financial services, with compensation based perhaps on flat fees, royalties or other arrangements). In relation to sales by ForeignAlpha Pty, AusDelta Pty Ltd is not a marketer to unrelated Australian parties but a mere post-box or store of marketing material. AusDelta Pty Ltd receives a fee for its services. We see that section 177DA creates an Australian tax risk relating to the non-Australian segments' activities, even where they are merely incidental preparatory or auxiliary.

- As for the AlphaGlobal example above, except that there are post-box and similar low-value services performed by a Hong Kong company HKAlpha. We see that section 177DA creates an Australian tax risk arising from non-Australian segments' activities, even where they are merely incidental preparatory or auxiliary.

- A mixed business model illustrating changes in business. The Australian operation of a foreign group was set up as a limited risk distributor (LRD) some years ago (or a buy/sell local subsidiary, same principles apply) shipping in packaged computer games and have been doing so for years. Over the years, the foreign business developed a new product in same business (or started to sell upgrades) online. The Australian management complain they are missing out on the revenue, and negotiated to amend inter-company agreements so that they generate additional cost-plus revenues for foreign company online sales, which continue to be made by the foreign entity. We submit that this scenario should not be caught by section 177DA as the Australian subsidiary makes no contribution and adds no value to the services supplied by the non-resident, and it is inappropriate to impute that connection. This scenario illustrates the practical problems of how do you draw the line - if they had not renegotiated the agreement, there would be no basis to establish a principal purpose of tax.
- Limited scope Australian activities by international financiers or providers of expertise re international investment or financial markets. An international finance/lending group has an Australian subsidiary of 2 people as a sales office in Australia: its function is to identify potential customers for services performed from London or Berlin or Paris or New York. Australian entity receives a minimal fee for its services commensurate with the transfer pricing value. Broad wording of draft law creates risk of Australian tax on non-Australian segments' activities.