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Dear Ashley

Tax Integrity: Multinational Anti-Avoidance Law

We welcome the opportunity to provide a submission on the Exposure Draft legislation *Tax Laws Amendment (Tax Integrity Multinational Anti-avoidance Law) Bill 2015* (ED) and accompanying Explanatory Material (EM), released by Treasury for public consultation on 12 May 2015.

KPMG is fully supportive of Australia's active participation in the Organisation of Economic Co-operation and Development (OECD) Base Erosion and Profit Shifting (BEPS) project.

As noted in our submission to the Senate Economics Reference Committee inquiry into corporate tax avoidance and aggressive minimisation, it is KPMG's view that Australia's response to addressing emerging global tax issues should be aligned with Australia's significant investment to date in relation to the multilateral G20 and OECD BEPS initiative. That is, KPMG regards multilateral collaboration as essential to ensuring that the gaps identified by the OECD BEPS initiatives are addressed comprehensively.

The stated policy intent of the ED, being to stop multinational entities using artificial or contrived arrangements to avoid a taxable presence in Australia, aligns with the core objectives of the ongoing OECD BEPS project. As such, it is KPMG's submission that the Government should proceed cautiously with this legislative proposal, to ensure that any proposed amendments give effect to clear policy intent only and avoid creating unintended or uncertain consequences or difficulties in the administration of Australia's tax law.

The Government has formed a clear policy position that, notwithstanding the ongoing work in relation to the OECD BEPS Project, immediate and unilateral action is required to counteract 'the most egregious tax avoidance arrangements'.

KPMG acknowledges that the Government will have considered prior representations submitting a preference for the Government to wait for completion of the OECD BEPS deliverable on Permanent Establishments (expected in October 2015) before developing its response. Nonetheless, this ED demonstrates that the Government has concluded that immediate action to address this issue is appropriate. As such, and without seeking to discount established concerns regarding the Government's decision to take unilateral action, this submission will not further agitate for debate on this aspect of the Government's stated policy.

The KPMG views expressed in this submission instead focus on strategic issues identified with the legislative proposal contained in the ED. The comments contained in this submission are designed to assist Government ensure that any changes are implemented in a manner consistent with the targeted policy intent, and provide certainty in terms of the administration of the proposed legislation for the Australian Taxation Office (ATO), taxpayers and tax advisers.

Our specific comments and recommendations in relation to the ED and EM are set out at Appendix 1.

We look forward to your consideration of this submission and would be pleased to discuss it with you further.

Yours sincerely

Grant Wardell-Johnson
Partner, Australian Tax Centre

Appendix 1

Policy intent of the Multinational Anti-Avoidance Law

Having regard to the Hon. Joe Hockey press release dated 11 May 2015 explaining the context of the proposed amendments, it is evident that the measure is intended to be a specifically targeted measure directed towards 30 large multinational entities. Similarly the Explanatory Material (EM) accompanying the Exposure Draft (ED) confirms that the multinational anti-avoidance law is intended to "target the most egregious tax structuring by multinational entities while limiting the impact on legitimate international business activities, to protect Australia's tax base".

However, when comparing the above stated objects to what is written in the Exposure Draft (ED), it is submitted that in its current form there is significant:

- uncertainty as to the application of key operative provisions; and
- risk that the measure in application could capture a broader class of arrangements.

Accordingly, the purpose of this submission is to focus on strategic issues to ensure that the proposed changes are implemented in a manner that is consistent with the targeted policy intent, and provide certainty in terms of the administration of the law for the Australian Taxation Office, taxpayers and advisers. We have split our submissions into 3 parts, addressing issues in relation to the targeting of:

1 Entities that will be subject to the new measure;

2 Schemes that will be captured by the measure; and

3 Consequences where requirements for application of the measures are satisfied.

1 Issues relating to entities that will be subject to the new measure

Global revenue threshold

The proposed measure would apply to multinational entities with annual global revenue that exceed $1 billion with the calculation of this threshold and the extent of the multinational entity's corporate structure to be determined by reference to consolidated groups and accounting standards. It is not clear how this threshold will match with the proposed $1 billion global revenue threshold that will apply in Australia's proposed implementation of new transfer pricing documentation standards ('Country-by-Country reporting measures') from 1 January 2016 as details of the proposed implementation are yet to be released.

To reduce compliance costs, we submit that a consistent revenue threshold methodology be adopted for both the proposed multinational anti-avoidance law and Country-by-Country reporting measures.

No or low tax condition

The ED refers to a non-resident "connected with a no or low tax jurisdiction" which is structured as a "two step rule" (i.e. positive limb and negative limb approach).

The first step is contained in subsection 177DA(8) and provides that the condition will be met if any of the activities of the non-resident, or (if the non-resident is a member of a global group) any other member of the global group, give rise to income that:

- is under a law of foreign country, or an arrangement with a Government or authority of a foreign country, subject to no corporate income tax, or to a low rate of corporate income tax (paragraph 177DA(8)(a)); or
- is not subject to corporate income tax under any Australian law or foreign law (paragraph 177DA(8)(b)).

In relation to this first step, no guidance is provided either in the ED or EM as to what constitutes a low rate of tax for purposes of paragraph 177DA(8)(a).

The second step contained in subsections 177DA(9) & (10) provides a carve out from the application of the no or low tax condition in subsection 177DA(8).

Subsection 177DA(9) provides that subsection 177DA(8) is inapplicable in relation to an activity that is not related, directly or indirectly, to the making supply in relation to the making of supplies to Australian residents.

Subsection 177DA(10) provides that the low or no tax condition does not apply in relation to an activity caught by the first step if the undertaken activity in relation to the making of Australian supplies constitutes substantial economic activity.

The expression 'substantial economic activity, relating to the supplies' as used in subsection 177DA(10) is not defined and no meaningful guidance is provided as to its interpretation in the EM. In the one example provided in the EM on this matter (Example 1.8 in the EM) it is concluded that the taxpayer can establish the activities in the low tax jurisdiction are substantial because "the taxpayer establishes that entity employs thousands of highly valuable employees who add significant value in relation to their Australian sales".

The helpfulness of the example could be enhanced by exploring why the activities add significant value to the entity's Australian sales.

It is also noted that the scope of subsection 177DA(8) taking into account the exceptions in subsections 177DA(9) and (10) could also unintentionally capture shipping operations which are not subject to corporate income tax (but instead subject to a shipping tax).

Lastly, subsection 177DA(11) puts the onus of proof on the taxpayer. Relevantly subsections 177DA(9) and (10) are taken not to apply in relation to an activity if the Commissioner has not been given information that establishes that there is either no connection with the supply or substantial economic activity is conducted. This raises the question of what such information needs to look like and also when it needs to be provided.

Given that the operation of the no or low tax condition puts the onus of proof on the taxpayer it would be beneficial if clarity were provided around the interpretation of key concepts. Accordingly it is submitted that:

- *A definition of the phrase "low rate of corporate tax" (in the context of paragraph s177DA(8)(a)) should be included in the ED which states in percentage terms what applicable corporate tax rates would be considered low. In our view the ED could state that corporate tax rates of less than 10% would be a "low rate of corporate tax".*
- *Further guidance should be provided as to what constitutes 'substantial economic activity' through additional EM examples. Such examples should deal with various categories of economic activity at various points on the "value-add spectrum" that could be undertaken by no or low corporate tax jurisdiction entities in relation to an Australian supply.*
- *Specific consideration should be given to ensure that the no or low tax condition is appropriately calibrated to ensure that unintended outcomes are avoided in connection with the shipping industry.*
- *Specific guidance should be provided in relation to the circumstances in which subsection 177DA(11) would apply. That is, there should be clear guidelines as to what information is required to be provided by the taxpayer to the ATO and when this information needs to be provided.*

2 Issues relating to schemes that will be captured by the measure

This part of the submission addresses technical issues regarding the articulation of schemes that are captured by the measure.

Activities are undertaken in Australia in connection with the supply

For the proposed measure to apply to a scheme, the scheme must involve "activities [that] are undertaken in Australia in connection with the supply" (per subparagraph (s177DA(1)(a)(iii)). The words "in connection with" are broad enough to include not only activities that are integral to the supply but activities that may be considered minor or indirect.

Having regard to the policy intent of the proposed measure it is submitted that the calibration of the nexus requirement in subparagraph 177DA(1)(a)(iii) should be more targeted. In this regard the EM states that:

> *1.57 As a result, **schemes are not caught by this measure where**, for example, a non-resident supplies goods or services through an independent agent or broker, or, **a non-resident supplies goods or services to Australian customers without any Australian presence being integral to the supply**"* [emphasis added].

KPMG submits that further clarification should be provided as to what activities undertaken in connection with a supply should be captured for consideration in relation a scheme in the context of subparagraph 177DA(1)(a)(iii).

Commercially dependent entities

For the proposed measures to apply in relation to a scheme, the scheme amongst other things must involve activities undertaken in Australia in connection with a non-resident's supply to a non-associated Australian resident where some or all of those activities are undertaken by an Australian resident or Australian PE of an entity who is an associate or is "commercially dependent" on the non-resident.

Whilst the associate test is defined and used commonly in existing tax law, the term "commercially dependent" appears to be a newly introduced concept that requires further exploration to determine the intent and meaning.

In this regard, the EM states:

> *"1.56 This will ensure that the measure will not capture schemes where the entity undertaking activity in Australia genuinely constitutes an agent of independent status. This draws on the concepts in paragraph 6 of the 'OECD Model Convention on Income and on Capital' as well as paragraphs (e) and (f) of the definition of 'permanent establishment' in section 6 of the ITAA 1936. It also draws on paragraph 7 of Article 5 of the United Kingdom Convention and corresponding provisions of other international tax agreements under the International Tax Agreements Act 1953.*
>
> *1.57 As a result, schemes are not caught by this measure where, for example, a non-resident supplies goods or services through an independent agent or broker, or, a non-resident supplies goods or services to Australian customers without any Australian presence being integral to the supply".*

As such, whilst the language in the EM introduces a new concept of "commercially dependent", the intention is to link this concept to an Australian resident or Australian permanent establishment (PE) that is not a broker, general commission agent or any other agent of an independent status acting in the ordinary course of their business.

Given the intent noted above in the EM, it is unclear as to why a new concept of "commercially dependent" entities is required to be introduced where the policy objective be achieved by the ED referencing existing concepts of "broker, general commission agent or any other agent of an independent status acting in the ordinary course of their business".

As a matter of tax administration it is submitted that where existing concepts and guidance can be applied in relation to the ED, then those concepts should be adopted in favour of introducing new concepts. Accordingly we submit that the concept of "commercially dependent" in the context of subparagraph 177DA(1)(a)(iv) should be removed and replaced with "entities other than a broker, general commission agent or any other agent of an independent status acting in the ordinary course of their business". An exclusion from the concept of an independent agent could be provided for those parties who work exclusively or almost exclusively for the non-resident along similar lines to that proposed by the OECD in Action Item 7.

Principal purpose test

The proposed measures apply a "principal purpose test" as opposed to the "sole or dominant purpose requirement" applicable in the existing general anti-avoidance rules in Part IVA. This purpose test contained in paragraph 177DA(1)(c) provides that the test is satisfied if a principal purpose (including where there is more than one principal purpose), was to obtain a tax benefit, or both to obtain a tax benefit and reduce a liability to foreign tax or other Australian taxes.

This purpose need not be the sole or dominant purpose but must be one of the main purposes, having regard to all relevant facts and circumstances. The EM states that the term principal purpose captures the language used in the *2014 OECD Report entitled "Preventing the Granting of Treaty Benefits in Inappropriate Circumstances*". That report was issued as part of the OECD BEPS Action plan 6 examining treaty shopping situations and the use of specific limitation of benefits rules and more general anti-abuse rules. When discussing the term "main purpose" that Report notes:

> *"29. …… , it is important to undertake an objective analysis of the aims and objects of all persons involved in putting that arrangement or transaction in place or being a party to it. What are the purposes of an arrangement or transaction is a question of fact which can only be answered by considering all circumstances surrounding the arrangement or event on a case by case basis. It is not necessary to find conclusive proof of the intent of a person concerned with an arrangement or transaction but it must be reasonable to conclude, after an objective analysis of the relevant facts and circumstances, that one of the main purposes of an arrangement or transaction was to obtain benefits under the convention.*
>
> *……*
>
> *31. The reference to "one of the main purposes" in paragraph 1 means that obtaining the benefit under a tax convention need not be the sole or dominant purpose of a particular arrangement or transaction. It is sufficient that at least one of the main purposes was to obtain the benefit. For example a person may sell a property for various reasons, but if before the sale, that person becomes a resident of one of the Contracting States and one of the main purposes for doing so is to obtain a benefit under a tax convention, paragraph 6 could apply notwithstanding the fact that there may also be other main purposes for changing the residence, such as facilitating the sale of the property or the re-investment of the proceeds of the alienation".*

KPMG submits that further guidance be given on the potential application of Part IVA to international business activities with emphasis on the purported counteraction of artificial and contrived arrangements to avoid a taxable presence in Australia .

3 Consequences where requirements for application of the measures are satisfied

This part of the submission addresses technical issues regarding the application of the proposed measure to schemes.

Quantification of tax benefits

Where the requirements for application of the proposed measure are satisfied in relation to a scheme, the normal consequences of Part IVA are engaged. That is the Commissioner is empowered to make a determination to cancel tax benefits in connection with the scheme.

To determine the existence of a tax benefit and to quantify it, it is necessary to compare the tax consequences that would have occurred by analysing the taxpayer's counterfactual. For schemes captured by the proposed measure, the EM contemplates that the determination of the relevant tax benefit in accordance with current sections 177C and 177CB, should be by reference to an alternative postulate based on the non-resident making supplies to Australian residents that were attributable to an Australian PE of the non-resident supplier.

In terms of practical application neither the ED nor EM provide guidance as to a number of application issues including:

- *where there are a number of alternative options to construct an alternate postulate that would result in sales being attributable to an Australian PE of the non-resident (eg. principal office or dependent agent), which alternative postulate should be chosen?*
- *what assets, functions and risks will need to be allocated to an Australian PE under an alternate postulate scenario and how would that reconstruction interact with the transfer pricing rules?*

KPMG again submits that more guidance in the EM should be provided in relation to the above application issues.