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

9 June 2015

Via Email: taxlawdesign@treasury.gov.au

Exposure Draft: *Tax Laws Amendment (Tax Integrity Multinational Anti-avoidance Law) Bill 2015*

Dear Sir /Madam

We refer to the Exposure Draft of the *Tax Laws Amendment (Tax Integrity Multinational Anti-avoidance Law) Bill 2015* (**the Draft Legislation**) and the accompanying explanatory memorandum (**the Draft EM**) concerning the proposed amendments to Part IVA of the *Income Tax Assessment Act 1936* (**ITAA 1936**) (**Proposed Amendments**).

The Draft Legislation and Draft EM were issued for public comment on 12 May 2015 as part of a range of measures coinciding with the release of the Federal Budget.

PricewaterhouseCoopers (**PwC**) is thankful for the opportunity to provide a submission in relation to the Proposed Amendments and welcomes the opportunity for continued involvement throughout the consultation process.

PwC acknowledges the desire for Australia to possess an adequate legislative means to counteract behaviours with the potential to impermissibly erode the Australian tax base. In this respect, we acknowledge the perceived concerns that the current Part IVA regime is inadequate to address certain arrangements where taxpayers might be considered to have artificially avoided the establishment of an Australian taxable presence and consequently avoided the attribution of associated business profits.

However, PwC believes the Proposed Amendments raise several concerns that require further consideration. In particular:

i. In seeking to implement immediate and unilateral action to counteract *"the most egregious tax avoidance arrangements*" Australia will be acting in a manner inconsistent with its prior commitment to consensus based resolution facilitated through the OECD's Base Erosion and Profit Shifting (**BEPS**) project. Whilst PwC is disappointed with this change in approach it is further unclear as to how these proposed unilateral amendments will interact with future recommendations to be provided as part of the ongoing BEPS project; and

ii. The Draft Legislation contains a number of ambiguous elements which, if passed in its current form, creates significant uncertainty. This will also add to costs for both the ATO (to administer the new law) and for taxpayers (to comply with it).

Each of the above concerns is elaborated upon in our attached submission.

* * * * *

We look forward to the opportunity of discussing our submission with you in further detail. In the interim, if you have any questions please contact Michael Bersten on (02) 8266 6858, Peter Collins on (03) 8603 6247 or Nick Houseman on (02) 8266 4647.

Yours sincerely

Michael Bersten	Peter Collins	Nick Houseman
Legal Partner	Partner	Partner
Tax Controversy	International Tax Services	Transfer Pricing

Tax Integrity: Multinational Anti-Avoidance Law

Submission in response to the Exposure Draft and Explanatory Memorandum to the *Tax Laws Amendment (Tax Integrity Multinational Anti-avoidance Law) Bill 2015*

Legislative background

In PwC's view, the current regime under Part IVA of the ITAA 1936 has and continues to operate as a 'best practice' general anti-avoidance rule (**GAAR**) to address incidents of impermissible avoidance in the Australian income tax system. In this respect, we note that the key elements of the Part IVA regime have been adopted in a number of GAARs operating in other jurisdictions across the globe.[1]

Notwithstanding the recent amendments enacted via the 2013 measures[2], PwC considers the fundamental principles relevant to Part IVA's operation have been well established and are now widely understood as a result of the common law developments throughout the course of its now 30 year history.

Despite this, PwC acknowledges the perceived concerns that the current Part IVA is inadequate to address certain arrangements where taxpayers artificially avoid the establishment of an Australian taxable presence and consequently avoid the attribution of associated business profits (the so called 'PE avoidance arrangements'). PwC understands that this concern stems from the perceived ability for taxpayers to argue that such a scheme was entered into for the dominant purpose of avoiding tax in a country or countries other than Australia (as opposed to being entered into for the dominant purpose of obtaining a tax benefit under s 177C of ITAA 1936).

The Proposed Amendments seek to address these concerns by inserting into Part IVA a new provision, s 177DA, and related definitions. Not only does this introduce a number of new principles into Part IVA; it also fundamentally alters the requisite purpose test needing to be satisfied prior to the Part applying.

Although not addressed in the Draft EM, we have concluded that these amendments were inserted into Part IVA to have the effect of overriding Australia's existing tax treaty obligations. This is because section 4(2) of the *International Tax Agreements Act 1953* (**ITAA 1953**) provides that Part IVA will prevail over a tax treaty to the extent of any inconsistency.

For the reasons that follow PwC considers that the Proposed Amendments, if enacted in their current form, are of concern on a number of fronts.

Difficulties with unilateral action

In seeking to implement the Proposed Amendments as an immediate response to counteract *"the most egregious tax avoidance arrangements"*[3] PwC considers that Australia will be acting in a manner inconsistent with its prior commitment to consensus based resolution facilitated through the OECD's BEPS project. The BEPS Action Plan explained that unilateral measures could lead to "global tax chaos"[4].

---

[1] See for example the GAARs operating in Hong Kong, Brazil, Ireland, Singapore and South Africa, etc

[2] *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Act 2013*

[3] Draft EM at paragraph 1.8

[4] *Action Plan on Base Erosion and Profit Shifting (2013)*, OECD, page 10

Whilst PwC is disappointed with this change in approach it is further unclear as to how the Proposed Amendments will interact with future recommendations to be provided as part of the ongoing BEPS project, including:

- *BEPS Action 7*: Preventing the artificial avoidance of PE status;
- *BEPS Action 6*: Preventing the granting of treaty benefits in inappropriate circumstances; and
- *BEPS Action 1*: The digital economy.

By way of example, we note that on 15 May 2015 the OECD released details on a series of revised proposals to clarify and expand the scope of the Permanent Establishment (**PE**) rules in Article 5 of the OECD Model Tax Treaty. The proposals establish specific recommendations to counteract PE avoidance arrangements. In essence, the circumstances where an agent may create a PE are to be broadened and it seems to us that this change would apply to the relatively small number of cases apparently targeted by the proposed s 177DA.

If the BEPS project runs its course and the PE definition is agreed to on a multi-lateral basis with our treaty partners, is it intended that s177DA will be withdrawn?

We also note that the Proposed Amendments intend to introduce a rule with the effect that Australia's current bilateral treaty obligations would not apply. For example, although s 4(2) of ITAA 1953 preserves the operation of Part IVA, there may be good grounds to challenge s 177DA in the current circumstances. This is because it might be open for a taxpayer to argue that s 177DA fundamentally changes the scope of Part IVA beyond what was in force at the time a tax treaty was agreed with other sovereign nations (see below in relation to the different purpose test and the inclusion of foreign tax benefits).

Ambiguity

A number of the principles newly introduced within the Draft Legislation are ambiguous and likely to lead to uncertainty in application.

As a matter of statutory interpretation, regardless of how clear or detailed the guidance provided within the Draft EM may be, any judicial review by the courts will necessarily start with the statutory text as appears in the Draft Legislation and may have little or no regard to the Draft EM when seeking to construe its meaning.

Consequently we would commend a focus on drafting the text of the legislation to be as unambiguous as possible, bearing in mind anti-avoidance rules always have an inherent uncertainty because of the importance of individual facts and circumstances.

In PwC's view, such ambiguity exists in relation to following elements:

pwc

In connection with a supply

Before s 177DA can be engaged it must be shown that activities are undertaken in Australia "in connection with" a supply made by the non-resident [s 177D(1)(a)(iii)].

We note that in the absence of any definition of what meets the standard of "in connection with" it is likely that the use of such terminology will lead to uncertainty in its application. In this respect we note that the ATO's published guidance within *Taxation Ruling TR 2014/9*[5] acknowledges that the meaning of this phrase will depend upon its statutory context and purpose (and which will necessarily be open to different interpretations).

"Commercially dependent on"

Section 177DA also requires that the Australian resident intermediary undertaking activities in connection with the supplies be either an associate of, or "commercially dependent on", the non-resident [177DA(1)(a)(iv)].

This prerequisite is said to ensure that the Proposed Amendments will not capture schemes where the intermediary "genuinely constitutes an agent of independent status".[6]

In PwC's view the phrase "commercially dependent on" is vague and ineffective in identifying a required standard of connection (or dependence) between the Australian resident and non-resident entity. The concept is not expanded upon in any of the materials referred to in paragraph 1.56 of the Draft EM and it is further unclear as to how the OECD materials would be relevant in this context. Moreover, even if such OECD materials were relevant it remains unclear as to whether reference is to be made to those materials as they currently exist or as they develop throughout the course of BEPS project.

"A scheme designed to avoid…"

Rather than objectively determining the purpose of a person who entered into or carried out the scheme (a task already required under s 177D of ITAA 1936), the Proposed Amendments now additionally require the purpose of the scheme itself to be assessed [s 177DA(1)(b)].

The purpose of the scheme is said to be assessed on the basis of the division of activities between the non-resident, the Australian resident and any other related party[7] and is suggested to satisfy the requisite criteria only where those activities have been split in such a way "so as to deliberately fall short of constituting a permanent establishment".[8]

Whilst noting the novelty of this newly introduced element and the uncertainty in how it is to be assessed relative to the factors under s 177D(2), we again consider the assessment criteria to be problematic in light of the ongoing work of the OECD with respect to BEPS Action 7. Specifically,

---

5 TR 2014/9: *"Petroleum resource rent tax: what does 'involved in or in connection with exploration for petroleum' mean?"*
6 Draft EM at paragraph 1.56
7 Draft EM at paragraph 1.16 and 1.63
8 Draft EM at paragraph 1.64

given the OECD is yet to conclude on a proposed basis for amending Article 5(4) to incorporate an 'anti-fragmentation rule' it may be the case that any future assessment under s 177DA is rendered wholly unnecessary in light of such activities now qualifying as a PE in Australia.

Notwithstanding the above concerns, if the amendments were to proceed in their current form PwC considers that the guidance within Example 1.13 and 1.14 of the Draft EM are at extreme ends of the spectrum (one involving the Australian subsidiary providing "limited customer services support" and the other involving the Australian subsidiary providing "significant levels of support to Australian customers") and are not instructive in illustrating the intended operation of subsection (1)(b).

In addition, given that s 177DA is to apply to tax benefits obtained *on or after* 1 January 2016 (irrespective of whether the relevant scheme was entered into before that day), it is unclear *when* you are required to assess the scheme's purpose and what the scheme is designed to do. Under the current s 177D, the required assessment is performed at the time the scheme is entered into.[9] It may be observed that this timing issue will in practice place considerable importance on the particularisation of what is the scheme. It may be observed that having regard to a time prior to the commencement date creates a semblance of retrospectivity for the enactment.

Principal purpose of a person/s

In seeking to deliberately depart from an assessment of the "sole or dominant purpose" of a person/s who entered into or carried out the scheme, the Proposed Amendments now require a determination of "a principal purpose" or multiple principal purposes of a person who entered into or carried out the identified scheme [s 177DA(1)(c)].

If a principal purpose of such a person was, or included, a purpose of enabling a taxpayer (or taxpayers) to either:

i. obtain a tax benefit; or
ii. obtain a tax benefit *and* reduce a liability to foreign tax and / or other Australian taxes

the scheme would thereafter be captured within the ambit of s 177DA.

Whilst acknowledging that the drafting of subsection (1)(c) has sought to draw upon those principles currently under ongoing examination under BEPS Action 6[10], the process for how you determine one or more of the principal purposes of a scheme participant remains unclear. In the absence of judicial clarification, administrative uncertainty will arise.

Connected with a no or low corporate tax jurisdiction

177DA also requires that the non-resident is "connected with a no or low corporate tax jurisdiction" [177D(1)(e)].

---

[9] *CPH Property Pty Ltd v Federal Commissioner of Taxation* (1998) 88 FCR 21 at 42; *FCT v Ashwick (Qld) No 127 Pty Ltd* (2011) 192 FCR 325 at [141]
[10] Draft EM at paragraph 1.70

Per s 177DA(8) such a connection will be satisfied if *any of the activities* of the non-resident or any other member of the global group give rise to income that is either:

i. subject to "no corporate income tax, or to a low rate of corporate income tax" under a law of a foreign country or under an arrangement with a foreign government[s 177DA(8)(a) - ***the no or low tax criteria***]; or

ii. not subject to corporate income tax under any Australian or foreign law [s 177DA(8)(b) - ***the stateless income criteria***].

A clear and obvious concern stemming from the drafting of subsection (8)(a) is the absence of any definition in relation to what constitutes a "low rate of corporate income tax".

PwC considers that the current ambiguity must be resolved by reference to objective criteria – that is, a rate expressly stated within the legislation (or regulations) to the ITAA 1936. We strongly recommend that the legislation must stipulate a rate of tax that is considered "low". Absent doing so, there is likely to be extreme uncertainty and disputation regarding this concept and we believe that it would be very difficult for a Court to resolve this issue.

Our suggestion is that low rate of corporate income tax be defined as anything less than 10%. This could be justified on the basis that 10% is the effective tax rate suffered under the Australian Offshore Banking Unit rules and is also the rate of tax imposed on offshore lenders (i.e. the domestic rate of interest withholding tax rate is 10%). In addition, in order to make the test practically workable, we suggest that there be a two tier test to operate follows:

i. the "low rate of corporate income tax" criteria will only be satisfied if the headline rate for all of the activities of the impacted entities [i.e. the non-resident and any other members of the global group] is at least 10%. If some income of those entities were concessionally taxed at less than 10% the carve-out would not be available. Such an approach would avoid the need to calculate an effective tax rate where, for example, a non-resident might have tax losses or is eligible for concessions such as accelerated depreciation or R&D.

ii. if the "low rate of corporate income tax" criteria under (i) is failed, then the impacted entity would need to demonstrate, for example, that its effective accounting tax rate is at least 10% in any particular year.

We further note that, as currently drafted, the "low rate of corporate income tax" criteria could also conceivably extend to capture the activities undertaken by certain tax-exempt entities (e.g. charities or sovereign wealth funds, etc). We recommend that the Draft Legislation stipulate that such entities will not be considered to have a "low rate of corporate income tax". In this respect, we refer you to a similar exclusion already provided in the United Kingdom with respect to their Diverted Profits Tax (**DPT**) regime.[11]

[11] *Guidance: Summary of amendments following the technical consultation*; HM Revenue and Customs, 20 April 2015, paragraphs 23 - 26 [https://www.gov.uk/government/publications/diverted-profits-tax-guidance/summary-of-amendments-following-the-technical-consultation#exclusion-of-charities-and-other-exempt-bodies]