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23 December 2016

cc. The Treasurer, The Minister for Revenue

Submission - Diverted profits tax 2016 Exposure Draft

Dear Sir / Madam

EY welcomes the opportunity to provide comments in relation to the 29 November 2016 Exposure Draft (*Treasury Laws Amendment (Combating Multinational Tax Avoidance) Bill 2017: Diverted profits tax* ("**2016ED**")) of the proposed Australian Diverted Profits Tax ("**DPT**") announced in the 2016 Budget.

After the May 2016 Discussion Paper *Implementing a Diverted Profits Tax* ("**MayDP**") EY made a submission in June 2016 ("**June submission**"). That submission set out some of our concerns with the DPT proposal from a tax policy perspective and from a law design perspective. We continue to hold the view that in the form proposed the DPT is misconceived and is contrary to Australia's best interests. We have not repeated here all of the reasons for those concerns from a high level tax policy perspective, including the 80% of Australian tax benchmark. We accept that the Government is entitled to make announcements to deal with issues magnified by public misperceptions of the Australian tax system.

In June 2016 EY submitted that given the wide reach and complexity of the DPT the measure required consultation before drafting commenced to settle the tax law design as well as policy issues.

We know that the focus of the Treasury, Office of Parliamentary Counsel, Australian Taxation Office ("**ATO**") and Government in recent months have been on tax and measures other than the DPT, which has affected the capacity to develop the DPT with full advice provided to Government.

Exposure drafts are an important mechanism to identify and rectify problems. We thank the Government for being prepared to issue the 2016ED as this very early stage draft with various issues as yet not drafted and not fully considered, most of which are noted in the draft explanatory memorandum. Since the 2016ED EY representatives have had consultations with Treasury, ATO and other stakeholders to provide initial input.

We submit that the 2016ED as currently drafted should not form the basis of a Bill. The 2016ED is very problematic when compared with the UK legislative approach to the UK DPT.

The drafting approach in this preliminary 2016ED has made the provisions extremely uncertain and confusing. They contain errors, many novel undefined terms, are not integrated into the rest of the Australian business and international tax system and will give rise to unnecessary litigation. The 2016ED operates to delegate quasi-legislative authority to the Commissioner to make law on the many undefined or unresolved issues, but with no guidance on parliament's objectives in introducing the DPT.

We are particularly concerned about the impact of the 2016ED on the international perceptions of Australia as a place to invest for foreign businesses and by foreign Collective Investment Vehicles ("**CIVs**"). The G20 and OECD have turned their attention in 2016/7 to "solutions to support certainty in the tax system with the aim to promote investment, trade and balanced growth." The 2016ED does not in our view meet this aim.

To assist in the redrafting of the DPT, our submissions on law design issues are summarised below. Given that the law design issues are so extensive, we do not raise many minor law drafting issues and will continue to share these with you.

1. The law should align to Government intention and that intention should be clearly expressed

The ED2016 goes well beyond any proposition consistent with the original intention which, we understood, was to provide the Commissioner a tool of last resort to deal with complex transfer pricing issues with uncooperative taxpayers.

The 2016ED amounts to a major revision of Part IVA ("**Part IVA**") of the Income Tax Assessment Act 1936 ("**ITAA36**") in relation to any transaction which a larger SGE taxpayer has with a foreign related party (not just transfer pricing issues). It:

- lowers the bar for application of the DPT component of the GAAR
- gives the Commissioner the power to impose a significant immediate cash payment obligation on a taxpayer in any tax controversy scenario notwithstanding other Australian integrity rules which might apply, with a higher tax rate than would normally apply
- overrides the effects of numerous other provisions of the tax law
- gives the Commissioner as administrator the power to force taxpayers to quickly concede or adopt income tax positions
- demands reanalysis of every related party transaction for all larger businesses, irrespective of whether the structure was established 20 weeks ago or 20 years ago.

The operative provision of the law is so widely drafted that any transaction, even between two unrelated SGE parties in Australia, attracts the DPT if one of the parties has a foreign associate. Those taxpayers must then go through the complex determination of a requisite principal purpose, or whether potential exclusions might apply.

As submitted later, we think the 2016ED needs to be replaced. The DPT must contain proper legislative expression of the policy, the parliamentary intent and law design.

That law design requires:

- the mechanism for the imposition of the DPT to be clearly articulated in the law as did the UK in its DPT. The law and not the EM and not the Commissioner, must outline clearly the process for identification of taxpayer behavior or facts which will cause the DPT to be considered
- a formal notification to the taxpayer of the potential or intent for an ATO to move to the DPT. The MayDP proposal for the issue of an interim DPT assessment needs to be reinstated or a formal equivalent process specified in the law, with some governance over the process.

2. Interaction with transfer pricing rules needs law design and clarity

The interaction of the DPT with the transfer pricing laws and processes needs to be clearly articulated in the law. This requires the law and not the EM and not the Commissioner to state clearly the primacy of the transfer pricing rules in Division 815 ("**Div 815**") of Income Tax Assessment Act 1997 ("**ITAA97**"), together with the limited circumstances in which the DPT proposal and escalation process mentioned above would apply.

Item 1 of our June submission outlined at some length the double jeopardy issues relating to transfer pricing issues. These appear not to have been considered for the 2016ED or the drafters did not have time to consider these. We submit that they should now be considered.

3. Interaction with thin capitalisation: exclusion of related party debt

The 5 December consultation of Treasury and ATO with EY identified that the interaction of the DPT with the thin capitalisation rules has not yet been drafted and was also omitted from the list of measures yet to be drafted, set out in para 1.108 of the draft explanatory memorandum. (This interaction is stated at para 34 of the MayDP, that "Where the debt levels of a significant global entity fall within the thin capitalisation safe harbour, only the pricing of the debt and not the amount of the debt will be taken into account in determining any DPT liability.").

However, as noted below and in our June submission, subjecting related party debt to the DPT, in addition to transfer pricing, thin capitalization and many other tax provisions is highly inefficient from a law design perspective. For this reason the UK excluded "excepted loan relationship" arrangements from its DPT. We submit again that Australia should follow that approach.

4. Exclusions Required

The drafting of exclusions from the DPT has not properly considered Australia's interests, efficient tax administration and compliance. We again submit these exclusions should be included.

First, the DPT should not apply where other strong Australian tax integrity rules and anti-avoidance rules apply. This is not just to avoid inefficient overlap, uncertainty and multiplied compliance costs for both the ATO and taxpayers. It is, more importantly, to avoid providing strong signals for companies with international businesses to not be based in Australia.

4.1 Exclusion of income of covered by Australian CFC rules

The DPT should not apply to income covered by the Australian Controlled Foreign Company ("CFC") rules. The Treasurer confirmed on 3 October 2015 that "Australia's CFC rules meet OECD best practice guidance." So at minimum, it is inefficient and unfair to apply the DPT, which the 2016ED allows, to:

- double-tax attributable CFC income or
- reconstruct foreign transactions by CFCs which are dealt with comprehensively under the CFC rules.

It might be suggested that Part IVA has not hitherto been applied to CFC situations. But the DPT is different to the current Part IVA, it lowers the bar, as Treasury and stakeholders have stated, and current Part IVA laws are not determinative for the DPT.

Even more problematically for Australia, if CFCs of Australian headquartered companies are to be subject to the DPT rules, this will create a significant disincentive to any Australian-headquartered international company which retains its headquarters in Australia.

Australia's government considered in 2003-2004 the potential redesign of Australia's CFC rules because they deter Australian companies from remaining based in Australia. A DPT applying to CFCs would provide a significant incentive for Australian based groups to consider relocating their headquarters overseas with only the Australian operations remaining in our country. This is against Australia's national interest.

4.2 Exclusion of insurance and reinsurance

We submit, as in item 9 of our June submission, that the DPT should not apply to offshore insurance or reinsurance activities. Division 15 of the ITAA36 adequately deals with such arrangements where the legislature so intended.

Similarly, the DPT should not apply to captive insurance entities that are exposed to significant losses under an arrangement(s) that transfer insurance risk(s). Such entities are normally authorised and registered to conduct an insurance business in the local offshore jurisdiction and have the financial capacity to pay any insurance claim that they are required to make in relation to the risk insured. Again, Division 15 of the ITAA 1936 adequately deals with such arrangements where the legislature so intended.

4.3 Exclusion of related party financing arrangements

We reiterate that from a law design as well as a tax policy perspective, the DPT should not be applied to financing and related arrangements (refer to Item 6 of our June submission). In particular, there should be an exemption for such arrangements from being regarded as having insufficient economic substance.

The DPT should carve out financing transactions as did the UK in its DPT. Australian cross-border financing arrangements are covered by thin capitalization, transfer pricing, debt-equity, TOFA, consolidation, Part IVA anti-avoidance rules (among others) and (in the near future) anti-hybrid rules.

The UK, identifying similar available laws in its tax system applicable to financing arrangements, excluded financing arrangements being excepted loan relationships from its DPT.

As noted above the MayDP proposed that DPT would apply to related party debt, not to recast the amount of the debt but to govern the pricing of the debt. Those rules have not yet been drafted and are to be drafted. However our larger law design submission is that applying the DPT to related party debt is hugely inefficient and duplicates the impact of Australia's recently replaced world leading transfer pricing laws of Division 815. Australia should follow the UK lead to avoid uncertainty and enhance efficiency.

4.4 Exclusion of Collective Investment Vehicle transactions

As we noted in item 8 of our June submission, Australia's economic interests mean that the DPT should not apply to Collective Investment Vehicles.

The UK DPT excludes, in essence, CIVs from the effective tax mismatch requirement: the UK DPT does not apply to a payment to an offshore fund or authorised investment fund which meets the genuine diversity of ownership condition or at least 75% of the investors are, throughout the accounting period, registered pension schemes, overseas pension schemes, charities or persons who cannot be liable for any relevant tax on the ground of sovereign immunity.

Australia should not apply the DPT to transactions involving foreign CIVs. Foreign CIVs invest into Australia and have transactions with Australian related parties (e.g. a foreign CIV invests in an Australian infrastructure project and makes a loan to that investee, or a foreign CIV invests in Australian real estate). A foreign CIV is in no position to know the profile of its investors including foreign pension funds and sovereign wealth funds. And in any event a large part of the investor pool will have zero or low tax rates. The DPT overlay provides a deterrent to investment into Australia.

To expose foreign transactions to DPT runs counter to Australia's objectives, like those of the UK, to attract global financial services activities and to attract foreign capital into Australian business-related investments. Australia has undertaken major tax policy reform to enhance our financial services rules, our rules for managed investment trusts and is currently actively considering the development of CIV rules.

We submit that, as in the UK, the DPT should not apply to transactions involving foreign CIVs.

5. Commencement date: exclusion of transactions in place for many years

An additional key exception, or application rule, on which we submitted in June was that the DPT should not apply to structures or arrangements which were established many years ago and which are a settled commercial structure for businesses.

We submit that if the DPT is to go beyond being a tool of last resort for complex TP matters and apply to reconstructed arrangements (as per 2 of the 3 examples in the MayDP) there should be some time limit in how far back the ATO can go in analysing the arrangement.

Consider for example a business where some IP was transferred out of Australia 10 years ago. The business and the ATO assessed the risk under Part IVA as it then stood, and the business has continued to be subject to Australia's tax laws and ATO scrutiny for many years. In these circumstances it is unfair (and virtually impossible) to now assess that old restructure using the new DPT Part IVA rules and then calculate some sort of diverted profit amount relating to a hypothetical revenue flow 10 years later. This amounts to, to use the words of the G20 / OECD uncertainty survey of October 2016 "retroactive changes to tax law." There needs to be some limit on this.

Our June submission was that the DPT should not be applied to transactions taking place under intercompany arrangements that have been put in place before the announcement by the Government of the introduction of the DPT. But if it was to apply to pre-existing transactions:

- The DPT should not be applied to reconstruct transactions more than five years after the end of the income year in which the first transaction relevant to the DPT assessment occurred.
- The DPT should not be applicable in respect of any inter-company arrangement that when initially implemented did not give rise to an effective tax mismatch. An Australian taxpayer should not be exposed to tax risk as a result of another jurisdiction reducing its tax rate after a transaction has been put in place.

6. Calculation of tax benefit: DPT should be outside Part IVA or a new Division in Part IVA

The decision to draft the DPT within Part IVA, Australia's General Anti Avoidance Regime (GAAR), has created major uncertainty by the proposed insertion of fragmentary DPT sections into Part IVA, with insufficient drafting to present it as a complete package.

In particular there is insufficient attention to the concept of tax benefit in relation to the DPT and the calculation of the tax benefit.

We observe that, even when considering whether a simple business transaction such as the purchase of goods or services, every affected party must work through complex Part IVA concepts of tax benefit or purpose to identify if its transaction is acceptable. By contrast the UK DPT took a much simpler "relevant alternative provision" approach which achieves this outcome more efficiently.

Our law design submission is that the DPT should be recast as a separate integrity measure not in Part IVA. The DPT applies to many more circumstances and to many more taxpayers than does the MAAL, and there is a greater need for it to have a standalone legislative identity not to be misplaced in fragmentary provisions within the GAAR.

If the DPT is to remain in Part IVA then:

- it must be drafted as a distinct Division of Part IVA, with an objects clause, a clear outline of its intended operation, a clear explanation of the interaction with the concepts of tax benefit contained in Part IVA.
- the DPT must specify the operation of the tax benefit rule in the DPT context, with a note or sub-section noting that this requires a "postulate that is a reasonable alternative to entering into or carrying out the scheme" (existing s177CB(2) of ITAA36. Alternatively a clearer alternative provision exclusion would assist in the drafting of Australia's DPT.

The DPT legislation needs these elements before launching into the application clause.

7. The “a principal purpose” test needs revision

The “a principal purpose” test needs revision. In particular:

- the treatment of foreign taxes needs law design consideration and revision concerning subnational and indirect taxes
- the “a principal purpose” test is drafted inconsistently with the major rules in Part IVA and even with the MAAL introduced 12 months ago, notably the new “reasonable to conclude” term which is undefined and which creates uncertainty
- it requires further legislative clarification, not in the EM or by the Commissioner in some later document, of non-tax financial benefits and how these are identified.

8. The sufficient economic substance (“SES”) test needs revision

The sufficient economic substance (“**SES**”) test, which is an important carve out from the requirement to work through the complex and uncertain “a principal purpose” test, needs attention. This includes the need for:

- formal definitions of sufficient economic substance in the legislation, not in the EM or by the Commissioner in some later document, including tax benefits and non-tax financial benefits and how these are identified
- referencing the OECD materials in the statute
- reconsidering why the SES test must be met by every single entity connected in any way with the scheme, so a de minimis or incidental participant causes failure of the test for all
- consideration of the SES in relation to financing transactions, if the Government does not accept our submission above that financing transactions should be excluded. The proposed exclusion of passive activities of the foreign party from the SES test would make it extremely difficult to comply with for many foreign entities with significant functions, assets and risks but which do not conduct an active business of moneylending.

9. The $25 million turnover exclusion needs revision

The $25 million turnover test, a carve out available instead of going through the “a principal purpose” test, needs attention. This includes:

- the need for the law, not the EM or the Commissioner, to explain “artificially booked turnover outside Australia”. We assume it relates to inclusion in accounting but the lack of legislative clarity adds uncertainty about general accounting for relevant businesses
- redrafting as, currently, even $1 of artificially booked turnover (whatever that might mean) would cause failure of the test.

10. The ‘sufficient foreign taxes’ exclusion needs revision

The significant foreign taxes exclusion, a carve out available instead of going through the “a principal purpose” test, needs attention. This includes:

- the need to include Australian taxes including withholding taxes in the additional taxes resulting from the relevant transactions
- clear inclusion of all foreign taxes in the calculation

11. Restricted DPT evidence rules need revision

The restricted DPT evidence provisions in the 2016ED need revision as they:

- appear to require taxpayers to identify and present every possible piece of information to the ATO, in any potential DPT scenario. This is unworkable.
- need to consider cooperative taxpayers which work with the ATO
- require clearer exclusions from their harsh application in the law, and clearer criteria for the Commissioner consent provisions. For example, evidence which existed before the period of the review and which the Commissioner has seen but which may no longer be in his possession cannot be presented in judicial review without approval of the Commissioner. Also, evidence which did not exist until after the period of the review cannot be presented in judicial review without approval of the Commissioner. As well, the situations of information not within the control of Australian taxpayers need elaboration, e.g. for joint venture structures.

12. Commissioner must have discretion on extent of DPT adjustment

The 2016ED, while giving the Commissioner huge powers of application of the DPT, provides no capacity for the Commissioner to apply judgment to the resulting potential DPT adjustment – the consequences of the DPT under the proposed s177M in the 2016ED appear to be binary "on" or "off", unlike Part IVA which allows for and requires proper administration by the Commissioner.

While the DPT may be intended as no more than a threat or incentive for the taxpayer to amend their income tax returns, the lack of any discretion for the Commissioner on the outcome of the DPT will inevitably lead to unfair outcomes. For example if, for a business and its transactions, it is reasonable to conclude that the proposed 177H should apply because one foreign element is designed for a principal purpose of foreign tax reduction, the overall additional foreign tax from the overall scheme is less than 80% of the Australian tax (assume it is taxed in the UK and therefore less than the 80% threshold), and any one entity did not have sufficient economic substance, then no carveouts apply and the DPT applies. There is nothing in the legislation to require fairness, or judgment. Mere statements in the EM or future statements by the Commissioner do not provide a basis of certainty in tax administration.

We submit the DPT should:

- contain a discretionary power for the Commissioner to assess the DPT against only a part of a scheme not all of the scheme
- reinstate the Commissioner's power to make compensating adjustments arising from the application of the DPT, under s177F, which has been eliminated under the proposed s177M."

13. Governance required of Commissioner's DPT decisions

The breadth of the 2016ED and its overreach, in providing extensive powers to the ATO combined with highly uncertain law, confirm our concerns of June 2016 about the coercive effect of the DPT and that the Commissioner's powers require oversight and governance, not merely internal processes of the ATO. Accepting that there are some situations where the DPT ought to be available to the ATO, the extraordinarily wide reach of the 2016ED and its powers conferred on the Commissioner require independent governance.

We submitted in June that whether the DPT is to be incorporated into the existing Part IVA as with the MAAL, or otherwise, that DPT assessments should not be able to be issued by the ATO unless and until the issue of the proposed assessment has been reviewed by an appropriately qualified individual (eg. a retired judge or appropriately qualified individual experienced in tax matters) or a panel comprised of members who are not current ATO officers. Before a DPT assessment should issue the responsible reviewing body should be satisfied:

- That there is a transfer pricing issue that is in dispute between the taxpayer and the ATO that involves an artificial or contrived arrangement as defined by the scope of the DPT (a prima facie case only); and
- That based on the history of the dealings between the taxpayer and the ATO, there is clear evidence of a lack of cooperation on the part of the taxpayer in respect of reasonable requests made by the ATO and
- that the dispute could not be determined appropriately under the transfer pricing regime that currently exists under Australian domestic law.

We do not expect the DPT external review should become an additional forum for the consideration of the substantive transfer pricing dispute but it should make a determination as to whether it is appropriate to effectively remove the dispute from the existing transfer pricing regime so that it is brought within the framework of a DPT disputed assessment.

This ‘pre-DPT’ external review could itself provide an incentive and forum for a resolution of the substantive dispute without the inflexible time periods, processes and financial penalties of the DPT having been triggered by the issue of an assessment.

The ATO appointed a former Federal Court judge to provide oversight over ATO selection and management of major tax appeals. That was a welcome move to justify trust in the ATO administration of those powers. We submit that a similar model of external oversight is required in relation to the decisions to impose DPT - not the existing GAAR panel (a limited-scope advisory panel) but a proper independent oversight.

14. Management of multiple parallel disputes

We expect that the Commissioner will take the view that a DPT assessment can be issued based on the existence of a tax benefit, as well as an amended income tax assessment to deny the tax benefit. This appears to be contemplated by the legislature and in the consultations.

We expect that there will be cases where the taxpayer considers the original income tax assessment to be correct and also that the DPT assessment should also not have issued. These assessments will need to be disputed on the basis of different evidence. We consider it necessary that the expected process for challenging assessments under Part IVC of the Taxation Administration Act 1953 is fully considered and set out in the Explanatory Memorandum.

15. 2016ED does not align with the current G20 themes of tax certainty

We submit that the abovementioned law design issues are consistent with the themes of tax certainty which have driven tax law development in Australia, and are consistent with the approach of the G20 and OECD in its identification in 2016 of the need for tax certainty which involves high quality law.

As the OECD stated in its 18 October 2016 release **–** link:

> ***“OECD launches business survey on tax certainty to support G20 tax agenda***
> *“18/10/2016 - The OECD received a strong endorsement from both the G20 Leaders and Finance Ministers to work on solutions to support certainty in the tax system with the aim to promote investment, trade and balanced growth.*
> *As part of a wider project, the OECD launches a to invite businesses and other stakeholders to contribute their views on tax certainty.*
> *… At the Hangzhou Summit in September 2016, the G20 Leaders emphasised the benefits of tax certainty in promoting investment, trade and balanced growth. Together with the IMF, the OECD was asked to continue working to enhance tax certainty.”*

The questions to survey participants on sources of uncertainty in relation to legal (tax) systems mention:

- “Unclear, poorly drafted tax legislation
- Complexity in the tax legislation (e.g. different definition of permanent establishment for VAT/GST and CIT purposes)
- Retroactive changes to tax law
- Lack of statute of limitations“

We suggest that these issues need consideration in the context of the replacement of the 2016ED.

16. Confirming our willingness to consult in the law development

The law design issues are of such significance that the 2016ED rules need fundamental law redesign. So this submission does not include minute legal drafting issues: we will provide those separately.

We are prepared to consult with Treasury and other stakeholders throughout January and 2017 to develop a new Exposure Draft of a DPT which supports certainty in Australia’s tax system.

If you would like to discuss these issues outlined in the attached submission, or any other aspects of the proposed DPT, please contact in the first instance Sean Monahan on (02) 8295 6226, Peter Janetzki on (03) 8650 7525, Alf Capito on (02) 8295 6473 or Tony Stolarek on (03) 8650 7654.

Yours sincerely

Attachment: Copy of EY 27 June 2016 submission

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Tackling Multinational Tax Avoidance: Implementing a Diverted Profits Tax Submission – Discussion Paper released 3 May, 2016

Dear Sir/Madam

Ernst & Young (EY) welcomes the opportunity to provide comments in relation to the Australian Government's proposal to introduce a Diverted Profits Tax (DPT) as described in the Discussion Paper issued by the Treasury as part of the Federal Budget announcements on 3 May, 2016 entitled: *Implementing a Diverted Profits Tax*.

This submission follows discussions with Treasury and the Australian Taxation Office (ATO). We wish to express our appreciation to those bodies and their staff for the opportunity to consult even at this early stage of the legislative development process. This submission is intended to focus on tax policy issues raised by the Government proposal.

In summary we make the following submissions:

1. As the Discussion Paper is an initial issue analysis and proposal, it is therefore imperative that after consideration of this round of preliminary feedback, that a more formal outline of the proposed law is issued for further consultation before the drafting of the legislation.

2. If enacted, the law should only be enacted with stringent external controls on its exercise given its capacity to be applied in an oppressive manner which would significantly curtail existing and legitimate taxpayer rights.

3. The law should not be enacted as appears to be proposed, as a tax separate to the Australian income tax. A new and distinct tax from income tax creates the real prospect of double taxation with no available redress for taxpayers and would therefore further undermine investor confidence in the Australian regulatory regime.

4. In order to give greater commercial clarity to a large body of taxpayers dealing with Australia's most favoured trading partners under circumstances where inappropriate tax outcomes should not be anticipated, the DPT should not apply where a transaction counter-party is a tax resident in a jurisdiction which is on the 'white list' for Australian CFC purposes.

5. Existing inter-company arrangements should be grand-fathered in order to mitigate the retrospective impact of the new rules.

6. The methodology proposed to calculate the DPT in 'excessive payment cases' is inappropriate, it needs to take account of allowable arm's length pricing otherwise it would lead to double taxation.

7. The DPT should not apply to financing transactions as they are comprehensively covered by Australia's existing tax integrity rules and reforms that are already being implemented or have been announced.

8. The DPT should not apply to collective investment vehicles.

9. The DPT should not apply to insurance, reinsurance nor captive insurance arrangements that genuinely transfer risk to offshore locations.

10. The 80% threshold for the effective tax mismatch test in order to apply the DPT is too high, as it is tested against Australia's existing internationally uncompetitive corporate tax rate of 30%.

11. The DPT should not be applied to reconstruct a related party transaction where, notwithstanding an effective tax mismatch the Australian tax liability has not been reduced

1. The broad scope and context of the DPT and current unresolved issues mean further consultation will be needed before drafting of law

The DPT is potentially extremely broad in its application.

For the sake of comparison Treasury previously stated in 2015 that the Multinational Anti-avoidance Law (MAAL) which commenced to operate from 1 January, 2016 would have a relatively narrow focus of 30 target companies. It is understood however that currently the ATO is actively engaged with approximately 170 companies that were identified as potentially impacted by the MAAL while many more have been required to review their own tax position in order to satisfy financial reporting requirements. In respect of the scope of the MAAL it is acknowledged that it is largely focused on US based multinational enterprises in the technology and related sectors. This is because the MAAL targets organisational structures that are commonly deployed as meeting the commercial needs of groups operating in those sectors.

The DPT has a much broader reach. It has the potential to be applied to any Australian entity, whether part of an inbound or Australian based multinational group, if that entity undertakes any related party transactions such that the Australian transfer pricing rules are applicable. As an illustration of the potential scale of the DPT coverage, the ATO has itself previously reported that of Australia's annual international trade , cross-border related party dealings would typically be expected to account for approximately half of that transaction flow. In any one year therefore cross-border transactions with a value measured in hundreds of billions of A$ could potentially be within the scope of the DPT.

At the same time the ATO has been highlighting the importance it places on tax and corporate governance by larger entities. So Government and the ATO should not expect that the DPT would not be an important tax risk issue for multinational groups unless and until they are approached by the ATO. This means that regardless of whether a DPT determination has been made by the ATO in respect of a taxpayer, and based on the breadth of the DPT testing that can be applied to a series of transactions, there will be a large taxpayer base that will need to review and assess its potential exposure annually under the proposed rules.

The Australian DPT is much broader than the UK DPT with much greater commercial impact.

- The UK DPT targets transactions with counter-parties that have a tax rate less than 16%, so it can be said to target what could be traditionally regarded as low tax jurisdictions.
- The proposed Australian DPT will apply where the foreign related party has a tax rate of less than 24% (see submission 9 below). The Australian DPT targets related parties in countries such as the UK and many OECD countries with tax bases that are based on current OECD guidelines.

In the context of the extremely broad scope of the DPT, the clearly stated purpose of the proposed rules is to give the ATO coercive powers to circumvent existing legitimate limitations on their powers in respect of transfer pricing matters.

The Discussion Paper (para 9) states that:

> *Australia's strong integrity rules together with the MAAL address many arrangements of multinational entities designed to avoid Australian income tax. However, as a practical matter, these rules can be difficult to apply and enforce in certain situations – particularly where the taxpayer does not cooperate with the ATO during an audit.*

Taxpayers and their advisers might dispute that there is any systemic lack of cooperation by taxpayers in transfer pricing audits that would justify the DPT as a response with its wide-ranging impact, rather than a more targeted policy response. The perceived constraints on the ATO in respect of its audit activity, that the ATO regards as presenting 'difficulty' as a 'practical matter' are however based on a combination of taxpayer rights, procedural fairness, and territorial limits on jurisdiction based on the rule of law. All taxpayers, including multinational corporate groups have a reasonable expectation that their rights will be able to be determined on a principled basis and applied with consistency. Merely relying on existing legal rights should not of itself constitute a lack of cooperation by a taxpayer.

The ATO's perceived difficulties may also be compounded by their own inflated expectations as to the documentation ordinarily produced as an incident of commercial activity.

The policy intent of the DPT is clearly stated that the potential imposition of the DPT by the ATO is to be a means to bring economic pressure on taxpayers involved in transfer pricing disputes to alter their tax position to that which would otherwise be based on their existing rights and current limitations on ATO powers. This context is, we believe, important in considering how the rules should be framed and how the governance and administration of these powers should apply, as outlined below.

This is also why in our view further consultation on the design of the proposed law is needed before legislation is drafted.

2. The DPT should only be enacted with stringent controls

As an example of its coercive objectives, the DPT is stated to "provide the ATO with greater powers to deal with taxpayers who transfer profits, assets or risks to offshore related parties using artificial or contrived arrangements to avoid Australian tax and who do not cooperate with the ATO" [Discussion Paper, para 12]. Statements such as this cause concern as without appropriate controls and governance around the new wide-ranging powers to be conferred on the ATO, the DPT would reserve solely to the ATO the role of determining not only when tax arrangements are artificial or contrived, but also when a taxpayer is to be regarded as not cooperating with the ATO.

The consequences for a taxpayer of the ATO making a determination that tax arrangements offend transfer pricing rules and that the taxpayer is being uncooperative are that a significant penalty tax can be imposed by the ATO in order to exert economic influence to compel the taxpayer to compromise its Australian tax position for reasons other than the technical merits of the transactions or structures under review.

External review prior to the issue of DPT assessments

Whether the DPT is to be incorporated into the existing Part IVA as with the MAAL, or otherwise, we submit that DPT assessments should not be able to be issued by the ATO unless and until the issue of the proposed assessment has been reviewed by a an appropriately qualified individual (eg a retired judge or appropriately qualified individual experienced in tax matters) or a panel comprised of members who are not current ATO officers. Before a DPT assessment should issue the responsible reviewing body should be satisfied of the following:

- That there is a transfer pricing issue that is in dispute between the taxpayer and the ATO that involves an artificial or contrived arrangement as defined by the scope of the DPT (a prima facie case only); and

- That based on the history of the dealings between the taxpayer and the ATO, there is clear evidence of a lack of cooperation on the part of the taxpayer in respect of reasonable requests made by the ATO and that the dispute could not be determined appropriately under the transfer pricing regime that currently exists under Australian domestic law.

We do not expect the DPT external review should not become an additional forum for the consideration of the substantive transfer pricing dispute but it should make a determination as to whether it is appropriate to effectively remove the dispute from the existing transfer pricing regime so that it is brought within the framework of a DPT disputed assessment.

This ‘pre-DPT’ external review could itself provide an incentive and forum for a resolution of the substantive dispute without the inflexible time periods, processes and financial penalties of the DPT having been triggered by the issue of an assessment.

Double jeopardy

We submit that another important control requires that before a DPT assessment can be issued the ATO must elect that, while the DPT assessment is in effect, the ATO could not make a transfer pricing determination in respect of the same transaction for the same income period under existing transfer pricing rules.

As part of its coercive mechanism described in the Discussion Paper, a DPT assessment by the ATO will require up-front payment of the penal DPT liability in full before it can be contested by a taxpayer. At the same time the ATO may exercise its power under existing transfer pricing rules to amend an assessment to tax for the same period as that covered by the DPT assessment in respect of the same related party transaction. That amended assessment would be expected to bring with it tax penalties, will impose the onus of proof on the taxpayer to demonstrate that the assessment is excessive, and any dispute of the assessment will not be a bar to summary judgement or recovery procedures by the ATO. Under existing guidelines we would expect the ATO to require the taxpayer to pay at least half of the amount of the disputed tax up front before continuing to pursue any rights of objection and appeal under existing rules.

Without an express bar to the duplicate issue by the ATO of both a DPT assessment and a parallel amended assessment to income tax under existing transfer pricing rules, the economic pressure on the taxpayer could be further aggravated beyond what is contemplated by the DPT.

We submit that current administrative guidelines in respect of double exposure to up-front tax payments in respect of the same disputed transaction would not be sufficient to protect taxpayers from the potentially oppressive application of the DPT and existing transfer pricing rules which, like the DPT, also give the ATO sweeping powers to reconstruct the same inter-company transactions that are within the scope of the DPT. Taxpayers will need legislative safeguards.

A failure to enact appropriate external controls on the exercise of this coercive power by the ATO has the potential to undermine confidence in the Australian tax system, would therefore represent another element of sovereign risk for foreign investors, and as a result act as a disincentive to foreign investment in Australia.

3. The DPT law should not be enacted as a tax separate from an income tax

We understand that the mechanism for the assessment of the DPT may be incorporated into the *Income Tax Assessment Act*. As with the MAAL it could be enacted within the General Anti-avoidance Rule in Part IVA of the 1936 Act. At the same time paragraph 41 of the Discussion Paper states that the DPT will not be deductible or creditable for income tax purposes and we further understand that the DPT would be imposed by Parliament in a *Ratings Act* that is separate from that which imposes income tax.

We submit that if the DPT is to be imposed, that the mechanism should be to levy income tax on an item of statutory income that can properly be made assessable to tax for an Australian taxpayer within the scope of s6-10 of the 1997 Act. Such an amount should be subject to tax under the *Income Tax Rates Act 1986* at the corporate tax rate with, a penalty tax of 10% imposed to bring it to a 40% effective tax rate. We further submit that only transactions that can be taxed within the above framework should be subject to the DPT (see comments below as to the scenario in Discussion Paper Appendix B.3)

A taxing mechanism for DPT outside of that which currently applies to income tax would mean that under Australia's various Double Tax Agreements the DPT would not be expected to fall within the scope of 'the income tax' for the purposes of 'Taxes Covered' by such treaties which are typically dealt with in Article 2(1) as taxes contemplated by the parties at the time the treaty was concluded. Instead, and at best, taxpayers would need to rely on Article 2(2) to seek agreement of the Competent Authority of the treaty partner countries that the DPT is 'identical' or 'substantially similar' to an income tax. Given the potentially arbitrary nature of transaction reconstructions under the DPT rules, the failure to take account of allowable arm's length payments (see below), the fact that it would be imposed outside of the income tax framework and not creditable against income tax, it is likely that the DPT would not be treated as an income tax by Australia's treaty partners.

Appendix B.3 of the Discussion Paper highlights this issue. The DPT assessment in that scenario purports to impose tax on a transaction between Foreign Co A and Foreign Co B, neither of which is an Australian tax resident. At the same time the jurisdiction of Co A would be expected to impose tax on the receipt (in that example at a rate 12.5%), possibly with a credit for withholding taxes deducted in the jurisdiction of Co B. It is submitted that this is an example where the DPT could not be said to be imposed on the income, profit, revenue, turnover or any acceptable measure of a taxpayer that would have standing to seek relief under Australia's tax treaty with either country A or B in the event that those either or both of those countries do in fact have a double tax agreement with Australia.

As with the UK DPT, the consequence of the Australian DPT not being respected as an income tax could have a profound effect on cross border investment.

Australia is only the first country to imitate the UK initiative and to implement its own version of the DPT. It is highly possible that other countries could follow with such unilateral action instead of adopting an OECD based coordinated approach. The practical impact of this proliferation and the DPT not being regarded as an 'income tax' in the absence of meaningful progress on BEPS Action Points 14 (Dispute Resolution) and 15 (Multi-lateral instrument to modify tax treaties), is that DPT would be beyond the coverage of double tax treaty relief whether by allowance of tax credits, agreed allocation of taxing rights, or mutual agreement procedures. As a result there will be a significant and growing area of cross-border tax disputes where Multinational taxpayers are exposed to potential double taxation without any recourse to a dispute resolution process. Again, this has the potential to create a disincentive to cross-border investment and undermine an intended operation of bi-lateral tax treaties being the facilitation of international capital flows.

4. **The DPT should not apply where a counter-party to a related party transaction with an Australian entity is tax resident in a jurisdiction that is on the 'white list' for Australian CFC purposes**

Seven countries are regarded by the Australian tax system as being on the 'white list' for Australian CFC purposes: the UK, the US, Canada, New Zealand, Japan, Germany, and France. There are a range of appropriate Australian tax compliance concessions currently available to Australian entities that have controlled subsidiaries in such jurisdictions. These concessions have been afforded as a matter of tax policy to Australian taxpayers because such jurisdictions are regarded by the Australian Government, as advised by its Revenue authorities, as being as being "closely comparable" tax jurisdictions (See: EM to 1997 CFC changes para 3.4). The attributes of a closely comparable tax jurisdiction are not controversial and would typically include a combination of:

- A headline corporate tax rate comparable to Australia's;
- A comprehensive tax base supported by integrity rules;
- Rules for taxpayers to establish tax residency;
- Preferably to have a double tax agreement with Australia; and
- The overall impact of the operation of the tax rules of such a jurisdiction is that tax deferral is not readily and broadly available and that income is therefore generally subject to tax on a current basis in a manner that as a matter of policy is sufficiently comparable with the Australian tax system.

Of the white listed countries currently only the UK has a headline corporate tax rate that would be considered low enough to give rise to an effective tax mismatch for DPT purposes however in all other respects it continues to demonstrate that its tax system continues to meet the other requirements for a comparable tax jurisdiction. Indeed while UK tax integrity rules have now inspired tax policy and law makers in Australia in respect of both the MAAL and the DPT, the UK has a comprehensive transfer pricing regime and anti-arbitrage rules that pre-date by many years any responses to the OECD BEPS Action 2.

Given the potentially broad scope of the DPT and the compliance burden on taxpayers such as listed companies to self-assess their potential DPT exposure annually for financial reporting purposes, it is submitted that improved clarity can be provided and compliance costs reduced in situations where inappropriate tax outcomes should not be expected to arise from cross-border transactions involving counter-parties in a 'white listed' jurisdiction. It is submitted that this should be achieved by the following features being written into the DPT rules:

- No effective tax mismatch can arise where the counter-party to a related party transaction is tax resident in a white listed country;

- Where an entity that is a counter-party to a related party transaction is tax resident in a white listed jurisdiction it should be assumed that based on the domestic law tax integrity rules applying in that jurisdiction, that the economic substance pre-condition for exclusion of the DPT will be satisfied by the taxpayer; and

- No conduit tracing should be possible in respect of back-to-back transactions to effectively look through an entity in a white listed jurisdiction to allow the ATO to reconstruct a transaction to determine that an effective tax mismatch arises as a result of a series of transactions. In effect, the DPT enquiry should go no further than a counterparty in a white listed jurisdiction.

Based on the standards that have been applied previously to such tax jurisdictions by Australian tax policy makers and continue to apply, there is no justification for applying the DPT where transaction counter-parties are tax resident in such countries. Conversely, the carve out we propose is a sensible compliance measure that is consistent with policy applied elsewhere under Australian tax rules.

5. Existing inter-company arrangements should be grand-fathered in order to mitigate the retrospective impact of the new rules

The DPT will have the potential to be applied with retrospective effect. The potential for an unreasonable application of the DPT can be demonstrated by reference to Appendix B.3 of the Discussion Paper which is referred to as an: *Example of an Understated Income Reconstruction Scenario.* The example describes an outbound asset transfer to a foreign affiliate of an Australian company. The income derived by the foreign affiliate in exploiting or using the asset gives rise to an effective tax mismatch such that the income derived by the foreign affiliate is within the scope of the DPT rules. As a consequence a DPT assessment is imposed on the Australian company that originally transferred the income producing asset to its foreign affiliate.

Without safeguards the DPT could be applied to a situation where an asset transfer as described in Scenario B.3 took place many years ago but as the asset continues to produce income that is taxed at a rate lower than 24% it is potentially subject to DPT. The asset transfer may have taken place at such a time that it can no longer reasonably be expected that the taxpayer would still retain records in respect of the initial transfer or that those responsible for the transfer are still available to explain the transaction. Based on the fact that many countries have been reducing corporate tax rates over time, it is also possible that when the initial asset transfer took place the use of the asset to produce income may not have given rise to an effective tax mismatch, however with subsequent tax rate reductions a tax mismatch may now arise, UK companies are an obvious example.

It is submitted that:

- The DPT should not be applied to transactions taking place under inter-company arrangements that have been put in place before the announcement by the Government of the introduction of the DPT.

- The DPT should not be applied to reconstruct transactions more than five years after the end of the income year in which the first transaction relevant to the DPT assessment occurred.

- The DPT should not be applicable in respect of any inter-company arrangement that when initially implemented did not give rise to an effective tax mismatch. An Australian taxpayer should not be exposed to tax risk as a result of another jurisdiction reducing its tax rate after a transaction has been put in place.

6. The methodology proposed to calculate the DPT in 'excessive payment cases' fails to take account of allowable arm's length pricing and will therefore lead to double taxation

Appendix B.1 of the Discussion Paper describes an: *Example of an 'Inflated Expenditure' Scenario*. The methodology for determining the DPT amount is described in para 32 of the Discussion Paper:

> *For the purposes of determining the DPT assessment, where the deduction claimed is considered to exceed an arm's length amount ('inflated expenditure' case), the provisional Diverted Profits Amount will be 30 per cent of the transaction expense.*

In such a case, the DPT is levied in respect of the entire transaction expense that should therefore be comprised of both an arm's length component and a component that the ATO believes to be in excess of the arm's length amount. In the event that the counter-party to the transaction is tax resident in a country that has a double tax treaty with Australia, to the extent that the DPT is levied in respect of the arm's length component of the transaction expense it would be exposed to double taxation.

The arm's length component of a transaction expense as described in Appendix B.1 cannot be a tax on the "income" of the Australian paying entity. Under Australia's tax treaties such an amount would be properly characterised as an allowable expense and would become the income of the counter-party. Any tax levied by Australia in respect of that component of the payment would be in breach of the relevant tax treaty and as such not subject to tax relief in the jurisdiction of the counter-party. Similarly we would not expect the parties to the transaction to be able to avail themselves of Mutual Agreement Procedures where taxes are levied in breach of a tax treaty.

The Discussion Paper (p12) does describe a situation where the DPT assessment is subsequently adjusted down to take account of the arm's length amount. This subsequent reduction does not mitigate the fact that the initial DPT assessment purports to levy Australian tax on an element of arm's length income that is derived by a foreign entity and assumes that it is an adjustment that the taxpayer agrees with.

We believe that this issue compounds our concerns raised at Item 3 above. The DPT will not only significantly increase the risk of double taxation but it will do so while denying taxpayers any structured bi-lateral forum within which to resolve such conflicts.

It is submitted that in issuing a DPT assessment the ATO must make a determination of an appropriate arm's length component of any payment and that any DPT assessment shall be limited only to an amount which the ATO alleges is excessive.

7. The DPT should not be applied to financing transactions

It is submitted that the DPT should not be applied to financing and related arrangements. In particular, there should be an exemption for such arrangements from being regarded as having insufficient economic substance.

In our view, Australia has robust transfer pricing and thin capitalisation rules which ensure that financing and related transactions are conducted on arm's length terms. The transfer pricing rules in particular apply the KERT analysis and this looks to the substance of the relevant transaction to determine appropriate pricing. In our view, such rules ensure that Australia is getting its fair share of the profits from transactions referable to economic activity in Australia.

For comparison purposes, we note that the UK DPT specifically excludes loans and related arrangements. In addition, the HMRC applies the KERT analysis (Key Entrepreneurial Risk-taking) in determining whether or not a particular transaction/arrangement has economic substance and therefore does not have a purpose of avoiding UK corporate tax. Provided that an appropriate arm's length pricing is applied to the financing and other arrangements, there is no purpose of avoiding the UK corporate tax and hence no liability to the UK DPT arises. In this regard, we note that HMRC excludes shared service arrangements and hedging arrangements of multinational banks as well as securitisation vehicles from the scope of the UK DPT. In our view, this is the correct approach.

Finally, the recently enacted multinational anti-avoidance rules exclude debt and equity interests from their scope. To not exclude similar arrangements from the DPT would produce anomalous outcomes.

8. The DPT should not be applied to collective investment vehicles

Australia is a capital importing country, and much of that capital is provided through offshore collective investment vehicles. Our Government and the Board of Taxation have acknowledged that the primary purpose of a collective investment vehicle is the pooling of funds from multiple investors (in the same or across different countries) to make significant investments. The collective investment vehicle allows investors to participate in more diversified investments on a larger scale. The underlying investments include equities, bonds, derivatives, real estate and infrastructure.

In all countries (including Australia), collective investment vehicles are structured as “flow-through” entities for tax purposes. This is premised on taxation being levied at the level of the investor in the home country as if the investor invested directly in the underlying investments. Our Government and the Board of Tax are supportive of this tax neutral treatment as evidenced in the Board of Taxation Report on the “Review of Tax Arrangements Applying to collective investment vehicles”.

Generally, collective investment vehicles hold investments through special purpose subsidiaries for legal and commercial reasons (e.g. ring-fencing of liabilities or risks associated with a particular investment). In light of the tax neutral principle applicable to collective investment vehicles, these subsidiaries are generally set up in countries with tax regimes that preserve tax neutrality. In this regard, any related party transaction is likely to fail the 80% threshold for effective tax mismatch.

In addition, as collective investment vehicles are effectively pooling entities only, all collective investment vehicles and their subsidiaries do not have any employees or operations. Generally, the collective investment vehicles and their subsidiaries are established in countries where the investment manager has a physical presence (e.g. investment managers, fund administrators etc.). Accordingly, unless substance is attributed to the substance of the investment manager, it will be difficult for all collective investment vehicles and their subsidiaries to meet the economic substance exclusion.

For completeness, some of the largest global investors comprise sovereign wealth funds and pension funds. In this regard, most sovereign wealth funds and pension funds are exempt from tax in their home country. Given the nature of these investors and the potential level of regulatory scrutiny in their home country, the proposed new rules should not apply to them. This is in line with the UK DPT.

Under the UK DPT, pursuant to subsection 107(6) of the Finance Act 2015 (UK), the effective tax mismatch requirement is exempted where they arise solely from:

“(d) a payment to an offshore fund or authorised investment fund—

  (i) which meets the genuine diversity of ownership condition (whether or not a clearance has been given to that effect), or
  (ii) at least 75% of the investors in which are, throughout the accounting period, registered pension schemes, overseas pension schemes, charities or persons who cannot be liable for any relevant tax on the ground of sovereign immunity.”

On this basis, and consistent with the UK DPT, we submit that the Australian DPT should include an exclusion for collective investment vehicles and their subsidiaries.

9. The DPT should not apply to insurance, reinsurance nor captive insurance arrangements that genuinely transfer risk to offshore locations

The DPT should not apply to offshore insurance or reinsurance activities. Division 15 of the ITAA 1936 adequately deals with such arrangements where the legislature so intended.

Similarly, the DPT should not apply to captive insurance entities that are exposed to significant losses under an arrangement(s) that transfer insurance risk(s). Such entities are normally authorised and registered to conduct an insurance business in the local offshore jurisdiction and have the financial capacity to pay any insurance claim that it is required to make in relation to the risk insured. Again, Division 15 of the ITAA 1936 adequately deals with such arrangements where the legislature so intended.

10. The 80% effective tax mismatch threshold for the non-application of the DPT is too high

The proposed DPT would only apply where a cross-border related party transaction gives rise to an effective tax mismatch meaning for example that the effective tax liability of the counter-party is less than 80% of the corresponding reduction in the Australian tax liability. It is not clear how this effective tax rate differential is to be determined and we anticipate that this is a matter for consultation when draft legislation is formulated. However as a policy matter we submit that the threshold is inappropriate.

The impact of the threshold basically means that if the counter-party to the transaction has a tax rate of less than 24% (against a 30% Australian tax rate) the transaction would be within the scope of the DPT.

It is worth noting that while Australian tax policy makers are imitating their UK counter-parts, the UK applies its DPT as part of a broader package of tax integrity rules to protect a tax base that is far more globally competitive than Australia's (tax rate, tax base etc).

In order to target cross-border related party transactions involving jurisdictions similar to those effectively targeted by the UK DPT rules (an effective tax rate of 16% or less), the Australian DPT threshold would need to be set at approximately 53% of the Australian tax rate.

- We submit that in order to reduce compliance costs and better target the application of the DPT, the threshold rate for an effective tax mismatch should be reduced to narrow the range of jurisdictions potentially within the scope of the DPT to more closely align with the UK rules.

- For the purposes of determining the existence of an effective tax mismatch, the tax liability of a foreign company needs to take account of foreign tax consolidation, grouping rules and rules for the taxation of flow through entities whereby tax liabilities may be discharged by an entity other than that which legally derived the relevant income. We understand that these issues have proved challenging when formulating the UK DPT.

11. The DPT should not be applied to reconstruct a related party transaction where, notwithstanding an effective tax mismatch the Australian tax liability has not been reduced

The DPT rules need to recognise that any relevant transaction may have a counterfactual scenario where, ignoring Australian tax issues, the Australian party to a cross-border related entity transaction would have had the same Australian tax outcome. This is clearly legislated in the UK DPT.

This issue is best illustrated by reference to the example in Appendix B.2 of the Discussion Paper which describes an Australian company leasing an income producing asset from a related party entity in a lower tax jurisdiction. The ATO would apply the DPT to deny the deductibility of the lease payments and re-characterise the transaction to be an equity funded purchase of a depreciable asset by the Australian entity. A reasonable and eminently commercial alternative hypothesis however is that instead of leasing the asset from the leasing entity in the low tax jurisdiction, the Australian entity would have leased the asset from its foreign parent in the higher tax jurisdiction that would not have given rise to an effective tax mismatch. In such a scenario the Australian tax base has not been eroded as the amount of Australian tax paid, including withholding taxes could be expected to be the same in either scenario.

The UK DPT rules have clear “alternative provision” rules that apply where the same of a similar transaction at the same price could be entered into by the Australian entity involving entities that would not give rise to an effective tax mismatch.

It is submitted that the DPT should not apply if on a reasonable alternative hypothesis the transaction could have been entered into by the Australian taxpayer without the effective tax mismatch arising.

Implementation issues

There are a range of issues to be considered in more detail in respect of the design and implementation of the DPT:

- The proposed time periods for review are inadequate and will not provide the taxpayer with sufficient time to properly address the issues raised by the ATO. This has the potential to erode existing taxpayer rights.

- The integration of the DPT with existing transfer pricing, thin capitalisation, anti-hybrid, Part IVA rules as well as taxpayer general rights of objection and appeal need to be fully considered and developed. Our earlier submission in respect of double jeopardy is an example of the interaction of the DPT and existing rules.

- The DPT should not introduce novel and untested principles to domestic tax rules but should apply established principles, for example following OECD guidelines in relation to the criteria for determining economic substance and similarly any tests to be incorporated into Part IVA should apply standards with which taxpayers, their advisers, and the courts are familiar with.

- Extensive aspects of the proposed DPT are unclear. We submit that detailed and informed consultation should be undertaken in the design and drafting of the proposed DPT legislation.

It is clear to us that an incoming Government will not have enough information to initiate drafting of the DPT at this stage, after the responses to the highly preliminary Discussion Paper with so many issues unresolved.

* * *

If you need any further input please contact any of Daryn Moore, Tony Cooper, Sean Monahan, Paul Balkus, Alf Capito or Tony Stolarek on (02) 9248 5555.

Yours faithfully

Ernst & Young

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