# KPMG submission

# Exposure Draft

# *International Tax Agreements Amendment (Multilateral Convention) Bill 2018*

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## 1.0 General

1.1 KPMG welcomes the opportunity to comment on the Exposure Draft (ED) of the *International Tax Agreements Amendment (Multinational Convention) Bill 2018* ("the Bill") and Explanatory Memorandum ("EM") as published by Treasury on 8 February 2018.

1.2 It should be noted in advance that the consultation process in relation to the MLI has been exemplary. In particular the Consultation Paper released in December 2016 which explained each of the provisions and Treasury's initial thinking on the position Australia should adopt should be commended on three grounds. First, it contained clear explanations of some very difficult technical provisions and was far more readable than the OECD documentation. Second, it was transparent. It would seem only one other country – the UK – provided a public document of their initial positions. Third, it lead to appropriate discussion which resulted in change from Treasury's initial position.

1.4 Our submission sets out recommendations in relation to the indicative positions that Australia has submitted to the OECD. Essentially our views can be placed in various categories:

| | |
|---|---|
| A. Fully agree with ED | Articles 3, 5-17 |
| B. Qualified agreement with ED but not significant | Article 4 |
| C. Disagree with ED | Part VI, Res 28(2)(a) |

## 2. Additional comments on positions where KPMG fully agrees with the ED

2.1 *Article 12*

In our view Australia has adopted a sensible position in relation to Article 12 including the qualifications contained in paragraph 4.26 (bilateral agreement) and 4.27 (potential future lift of reservation). The global community – beyond the tax community - is clearly questioning whether the international tax rules which draw a delineation between selling *to* a country (non-taxable) and selling *within* a country (taxable) are correctly drawn. Whilst Article 12 has considerable merit in drawing a new delineation, it is not in Australia's interests to agree to new boundaries where

there is no international consensus to do so. Indeed there is a significant risk to our revenue base. Such risks can be evaluated on a case-by-case basis on a bilateral basis. Moreover if in the future, there is sufficient international consensus to agree to a new delineation, Australia could reconsider its position in that environment.

2.2 *Article 13*

There is a question of whether, with the adoption of Option A in Article 13, together with the position adopted in Article 7, whether the anti-fragmentation rule in Article 13 is required. This question is one of balancing the additional complexity of adopting the specific anti-fragmentation rule with the desire to go with an OECD consensus. On balance, we believe the position adopted is reasonable.

## 3. Qualified agreement with the ED

3.1 *Article 4*

Australia has indicated that it will adopt Article 4's expanded set of criteria for determining the residence position of an entity that is resident in both jurisdictions under respective domestic laws. It also intends to make the reservation to deny treaty benefits completely, where the two competent authorities have been unable to reach an agreement on the entity's jurisdiction of residence.

We see little possibility of disadvantage for Australia if it retains the Competent Authority discretion to allow relief from tax, in circumstances where it cannot agree with the other country on the entity's residence position. It would seem that implicit in the argument to fully deny relief, is a belief that the dual residence would arise from advertent tax planning. This is likely but may not always be the case. Thus we believe Australia should adopt Article 4 of the MLI and withdraw its reservation under Article 4(3)(e).

**Recommendation 1:**
Australia should adopt Article 4 of the MLI and withdraw its reservation under Article 4(3)(e) in respect of replacing the last sentence of Article 4(1).

## 4. Disagreement with the ED

4.1 *Part VI - Mandatory binding arbitration*

We support Mandatory Binding Arbitration and the positions adopted by Treasury with the exception of the framing of the reservation, pursuant to Article 28(2)(a), to exclude any case from the scope of Part VI to the extent that it involves the application of Australia's general anti-avoidance rules contained in Part IVA of the ITAA 1936 and section 67 of the FBT Assessment Act.

We recognise that Australia has long adopted the position that treaty provisions should not be used to override anti-avoidance provisions. We also recognise that the proposed position is consistent with the position adopted in Canada, Germany, Italy and New Zealand and, possibly Singapore. Further, Japan appears to be the sole significant country that is likely to refuse to enter into mandatory binding arbitration with Australia on the basis of the proposed reservation.

However, we suggest that the reservation should be narrowed to exclude the operation of an anti-avoidance provision *the operation of which is duplicative of the ordinary transfer pricing rules*. This aimed at the DPT.

Our fear is that a future Revenue Administration will tactically use the DPT to ensure that a matter is not subject to mandatory binding arbitration on an ordinary transfer pricing dispute.

It is clear that the scope of the DPT moves beyond general anti-avoidance. At the very least, practically, the DPT could be applied by the Commissioner in a normal transfer pricing dispute where the Commissioner has formed the view that the taxpayer has been recalcitrant in providing information and an adverse inference on purpose can be drawn from that apparent recalcitrance. This is not a domain in which arbitration should be denied.

Consideration should be given to refining the reservation under Article 28(2) to exclude cases where the matter in dispute is whether the "sufficient economic substance" test is satisfied under Section 177M of the *Income Tax Assessment Act* 1936.

This is essentially an analysis of whether the compensation for the assets, functions and risks is appropriate in relevant jurisdictions. This should be subject to mandatory binding arbitration.

**Recommendation 2:**

Australia should modify its reservation to Part VI on mandatory binding arbitration on the operation of anti-avoidance provisions in Part IVA such that a dispute on the operation of the sufficient economic substance test in Section 177M does not preclude mandatory binding arbitration.