Treasury Laws Amendment (Making Sure Multinationals Pay Their Fair Share of Tax in Australia and Other Measures) Bill 2019

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Date introduced: 4 July 2019
House: House of Representatives
Portfolio: Treasury
Commencement: The first 1 January, 1 April, 1 July or 1 October after Royal Assent.

Links: The links to the Bill, its Explanatory Memorandum and second reading speech can be found on the Bill’s home page, or through the Australian Parliament website.
When Bills have been passed and have received Royal Assent, they become Acts, which can be found at the Federal Register of Legislation website.
All hyperlinks in this Bills Digest are correct as at July 2019.
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The Bills Digest at a glance

The purpose of the Treasury Laws Amendment (Making Sure Multinationals Pay Their Fair Share of Tax in Australia and Other Measures) Bill 2019 (the Bill) is to implement three distinct tax related measures that the Government announced in the 2018–19 Budget, namely:

- tightening the thin capitalisation rules for multinational entities
- requiring offshore online hotel booking providers to include hotel room bookings in calculating their business turnover for the purposes of the GST and
- removing the luxury car tax on re-imported cars sent overseas for refurbishment.

History of the Bill

The Treasury Laws Amendment (Making Sure Multinationals Pay Their Fair Share of Tax in Australia and Other Measures) Bill 2018 (the 2018 Bill) was introduced into the House of Representatives on 20 September 2018. The 2018 Bill lapsed when the House was dissolved on 11 April 2019.

The current Bill differs from the 2018 Bill substantially. The 2018 Bill consisted of seven schedules, while the current Bill consists of three. Proposed reforms to the Research and Development (R&D) Tax Incentive and to the definition of Significant Global Entity (SGE) which were in the 2018 Bill are not included in this Bill. The status of these reforms, which were also announced in the 2018-19 Budget, is unknown.

The previous Bill was considered by the Senate Standing Committees on Economics (the Economics Committee) and its final report was released on 11 February 2019. The Economics Committee noted significant concerns raised by stakeholders on the proposed changes to the R&D tax incentive in the previous Bill and recommended that the Senate defer consideration of the 2018 Bill until further examination and analysis of the proposed R&D changes could be undertaken. The Committee supported changes to the SGE definition which were in Schedule 7 of the 2018 Bill.

The three schedules contained in this Bill that were in the 2018 Bill have not changed and the Economics Committee supported these changes.

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2. Ibid., p. 34.
3. Ibid., p. 33.
4. Ibid.
Structure of the Bill

The Bill consists of three schedules:

- Schedule 1 of the Bill amends the *Income Tax Assessment Act 1997* (ITAA97) to implement proposed changes to Australia’s thin capitalisation rule and makes consequential amendments to the *Income Tax Assessment Act 1936* (ITAA36).
- Schedule 2 of the Bill amends the *A New Tax System (Goods and Services Tax) Act 1999* (the GST Act) to implement proposed changes to GST for online hotel booking providers and
- Schedule 3 of the Bill amends the *A New Tax System (Luxury Car Tax) Act 1999* (the LCT Act) to implement proposed changes to the luxury car tax on reimported vehicles.

The Bills Digest is structured to discuss each of these schedules separately.

Committee consideration

**Senate Selection of Bills Committee**

The Senate Selection of Bills Committee determined that the Bill should not be referred to a committee for inquiry. As discussed in the History of the Bill section of this Digest, the Bill’s provisions were considered and supported by the Senate Standing Committees on Economics, in the context of the 2018 Bill.

**Senate Standing Committee for the Scrutiny of Bills**

The Senate Standing Committee for the Scrutiny of Bills had no comment on the Bill.

**Statement of Compatibility with Human Rights**

As required under Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011* (Cth), the Government has assessed the Bill’s compatibility with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of that Act. The Government considers that the Bill is compatible.

**Parliamentary Joint Committee on Human Rights**

At the time of writing this Digest, the Parliamentary Joint Committee on Human Rights had not yet reported on the Bill.

**Policy position of non-government parties/independents**

At the time of writing, the position of non-government parties and independents on the Bill are not known. The Senate Economics Committee, which had members from the Australian Labor Party and the Australian Greens, supported the schedules in the 2018 Bill that are retained in the current Bill and there were no dissenting reports.

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8. The Statement of Compatibility with Human Rights can be found at pages 27–28 of the *Explanatory Memorandum* to the Bill.
Schedule 1 – Thin Capitalisation

Background

What are thin capitalisation rules

Australia’s thin capitalisation rules are a multinational tax avoidance rule under Division 820 of the ITAA97 that operate to limit the amount of interest expenses a foreign controlled Australian entity, an Australian entity that operates internationally or a foreign entity that operates in Australia can claim as a deduction against their taxable income. This applies to both entities investing into Australia (‘inward investing entities’) and Australian entities investing overseas (‘outward investing entities’). The rules are designed to prevent multinational entities from reducing their taxable income in Australia by loading their Australian operations with excessively high levels of debt.

Broadly, these rules seek to set a ‘maximum allowable debt’ amount, according to prescribed tests. Where an entity exceeds this maximum allowable debt amount they are considered thinly capitalised and will not be able to claim interest deductions on the interest amounts that exceed the prescribed test.

There are three prescribed tests for determining whether an entity is thinly capitalised (an entity only needs to satisfy one). These can be broadly described as follows:

- **The safe-harbour limit ratio**: this sets out the amount of deductible debt that an entity can hold as a percentage of its asset holdings. For example, for non-financial entities this ratio is three to five, in other words, the maximum allowable debt amount is $3 of debt for every $5 of assets.

- **The arm’s length test**: requires an entity to establish that the amount of debt that the entity has, and consequently the deductions arising from that debt amount, have been entered into on arm’s length terms. That is, an independent party would have lent that amount to the entity.

- **The worldwide gearing limit**: An amount that represents the average gearing ratio (debt to equity) of the entity’s worldwide group. Generally, debt deductions would be allowed so long as the Australian entity’s debt to equity ratio does not exceed the debt to equity ratio of the entity’s global group.

Interest deductions on debt levels in excess of a maximum allowable debt amount are denied. These tests vary depending on whether an entity is an inward investing entity or an outward investing entity (or both). It also varies if the entity is a financial entity, recognising that a higher level of leverage is consistent with the nature of their business. Different tests also apply for authorised deposit taking institutions.

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12. Ibid., sections 820-95, 820-195 and 820-205.
13. Ibid., sections 820-105 and 820-215.
15. Ibid., subdivisions 820D and 820E.
Proposed changes

Asset revaluations for thin capitalisation purposes

Generally an entity is required to comply with the accounting standards set by the Australian Accounting Standards Board (AASB) in measuring its assets, liabilities and capital for the purpose of calculating the relevant tests under the thin capitalisation rules. However, an entity may be able to depart from the accounting standards when revaluing assets for thin capitalisation purposes, or for the purpose of valuing assets which are internally generated by the entity and/or for which there is not an active market. This treatment can result in a difference in the valuation of these assets for tax purposes compared to what the entity reports in its financial statements.

The ATO has previously identified, in taxpayer alert TA 2016/1, circumstances where entities have been using revaluations or intangible asset valuations to inappropriately increase their maximum allowable debt amounts under the safe harbour limit ratio. The ATO advised that it was:

... reviewing arrangements where internally generated intangible items have been inappropriately recognised as assets, or have been over valued or inappropriately re-valued, with the consequence of increasing an entity's maximum allowable debt limit for thin capitalisation purposes.

The ATO has also noted that the value of asset revaluations has increased substantially since reforms to thin capitalisation rules in 2014 that tightened the prescribed tests for thin capitalisation.

The changes proposed by the Bill would require entities to use the asset values in their financial statements and no longer permit entities to revalue assets specifically for thin capitalisation purposes.

A transitional rule would allow entities to rely on revaluations of assets made prior to the announcement of this measure in the 2018–19 Budget on 8 May 2018 up until 1 July 2019.

Classification of head companies of tax consolidated groups

Current tax rules allow certain foreign head companies or multiple entry consolidated (MEC) groups that control groups in Australia to be classified as outward investing entities, if, in addition to controlling Australian entities, the foreign head company also controls foreign entities or has foreign permanent establishments. This allows these foreign companies to benefit from thin capitalisation rules that are intended for Australian entities investing overseas.

Under the proposed changes, these foreign controlled companies will be treated as both outward and inward investing entities.

Position of major interest groups

In a submission to the Senate Economics Committee review of the 2018 Bill, the Tax Justice Network stated that it supported measures to strengthen Australia’s thin capitalisation rules.

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16. ITAA97, sections 820-680, 820-683 and 820-684.
17. ATO, Taxpayer Alert, ‘Inappropriate recognition of internally generated intangible assets and revaluation of intangible assets for thin capitalisation purposes’, TA 2016/1, op. cit.
**Financial implications**

The changes to thin capitalisation rules are estimated to increase revenue by $240 million over the 2018–19 Budget forward estimates period.\(^{20}\)

**Table 1: Thin capitalisation—financial implications**

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\(^{20}\)Explanatory Memorandum, Treasury Laws Amendment (Making Sure Multinationals Pay Their Fair Share of Tax in Australia and Other Measures) Bill 2019, p. 3.

**Key issues and provisions**

Subsection 820-680(1) of the *ITAA97* provides that for the purposes of the thin capitalisation rules in Division 820 of the *ITAA97* an entity must comply with Australian accounting standards in valuing its assets, liabilities and equity capital.

However, subsections 820-680(2) to 820-680(2E) of the *ITAA97* provide that assets can be revalued to a value that is different to that disclosed in financial statements and the requirements for doing so.

**Item 11 of Schedule 1** proposes to repeal subsections 820-680(2) to (2E) *ITAA97* and require that all valuations for thin capitalisation purposes be aligned with those disclosed in financial statements.

**Item 11** would replace subsections 820-680(2) to (2E) with proposed subsections 820-680(2) and 820-680(3). **Proposed subsection 820-680(2)** provides that where an entity is required by Australian law to prepare financial statements in accordance with accounting standards, then the asset, liability and capital values in these financial statements must be used for thin capitalisation purposes.

**Proposed subsection 820-680(3)** provides that where a valuation period for thin capitalisation purposes overlaps multiple periods for which financial statements are prepared, then the method for valuing assets, liabilities and capital for thin capitalisation purposes must be the same as the method used in most recent of these periods.\(^{21}\)

**Item 13 of Schedule 1** also proposes to repeal both sections 820-683 and 820-684 of the *ITAA97* thereby removing the ability of entities to revalue intangible assets differently for thin capitalisation purposes.

**Items 4 and 5 of Schedule 1** amend subsection 820-583(5) of the *ITAA97* to remove existing provisions which provide that a head company of a consolidated group or of a MEC group is not an inward investing entity if it is also classified as an outward investing entity. **Items 6 and 7** amend subsection 820-583(6) of the *ITAA97* to make the same amendment for financial entities. This provides that these entities can be classified as both inward and outward investing entities. These changes would prevent affected entities from applying certain modifications to the thin

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\(^{20}\)Explanatory Memorandum, Treasury Laws Amendment (Making Sure Multinationals Pay Their Fair Share of Tax in Australia and Other Measures) Bill 2019, p. 3.

\(^{21}\)There appears to be a drafting error in **item 11 of Schedule 1** to the Bill. It inserts subsection 820-680(3) into the *ITAA97*, but such a provision already exists and is not repealed by the Bill. Current subsection 820-680(3) provides that the requirement in subsection 820-680(1) for an entity to comply with accounting standards in valuing its assets, liabilities and equity capital applies whether or not accounting standard would otherwise apply to the entity.
capitalisation rules that only apply to entities which are classified as either inward investors or outward investors, but not both. For example, section 820-37 of the *ITAA97* which provides that the thin capitalisation rules do not apply to entities whose average Australian assets make up more than 90 per cent of the entities average total assets.22

**Part 2 of Schedule 1** contains application and transitional provisions for the proposed changes to thin capitalisation rules.

- **Item 17** provides that the proposed changes to valuation rules in Schedule 1 apply to valuations made after 7.30 p.m., on 8 May 2018 – the release of the 2018–19 Budget. Any valuations made prior to this time can only be relied on for income years beginning before 1 July 2019.

- **Item 18** provides that the amendments at items 4 to 7 of Schedule 1 (the changes to rules for consolidated groups and MECs) apply in relation to financial years commencing after 1 July 2019.

**Schedule 2 – Online hotel bookings**

**Background**

Goods and Service Tax (GST) is applied on the supply of commercial accommodation when the supply is (amongst other things) made by an entity that is registered or required to register for GST. An entity carrying on an enterprise is required to register if their GST turnover equals or exceeds the registration turnover threshold of $150,000 (for non-profit bodies) and $75,000 (for other bodies who are not non-profit).23

Currently offshore suppliers of rights or options to use commercial accommodation (such as online hotel booking services) are not required to include these supplies in calculating their GST turnover. This can mean that these offshore providers are not required to register for GST and consequently, do not have to apply GST to the mark-up they charge for booking accommodation in Australia.

In the 2018–19 Budget, the Government announced that offshore sellers of hotel accommodation in Australia will be required to calculate their GST turnover in the same way as local sellers, thereby subjecting these transactions to GST.24

The amendments would not apply to supplies of hotel accommodation where the offshore provider is merely acting as an agent on behalf of a hotel in Australia. Under these arrangements the hotel is the supplier of the accommodation and has the obligation to apply GST to the sale.25

**Position of major interest groups**

The Accommodation Association of Australia (‘AAoA’) made a submission to the Senate Economics Committee inquiry into the 2018 Bill (whose provisions in relation to this reform are identical to this Bill). The AAoA did not support the changes proposed by the 2018 Bill arguing that the additional tax on online hotel booking operators will be passed on to domestic accommodation

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22. *Section 820-37, ITAA97.*
providers. In the AAOA’s view this would amount to an additional tax on accommodation and have negative impacts on domestic tourism.\(^{26}\)

Further, the AAOA argued that it would be unlikely that any additional GST will be collected by the Australian Government under the proposed arrangements. The AAOA suggests that since the proposed amendments do not apply to agents operating on behalf of domestic hotel providers, online travel agents will use their superior market position to re-negotiate their arrangements with hotels such that they act solely as agents. However, in such circumstances the requirement to charge GST would apply to the hotel provider.\(^{27}\)

A number of online accommodation providers made submissions to the Senate Economics Inquiry into the 2018 Bill and raised no significant objections.

Booking.com stated that under its current business model, it acts only as an agent between accommodation providers and guests and as such does not anticipate being affected by the amendments.\(^ {28}\) Likewise, Airbnb stated that the proposed changes would not affect it as it operates under an agency model.\(^ {29}\)

Expedia Group raised no objections to the proposed changes and stated that it was already making necessary changes to comply with the proposal.\(^ {30}\)

**Financial implications**

The changes to GST arrangements for online hotel bookings are estimated to increase revenue by $15 million over the 2018–19 Budget forward estimates period.\(^ {31}\)

**Table 2: Online hotel books—financial implications**

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**Key issues and provisions**

**Item 3 of Schedule 2** of the Bill proposes to repeal paragraphs 188-15(3)(c) and 188-20(3)(c) of the GST Act. This would remove the exception for supply of a right to use commercial accommodation

\(^{26}\) Accommodation Association of Australia (AAA), Submission to Senate Standing Committee on Economics, Treasury Laws Amendment (Making Sure Multinationals Pay Their Fair Share of Tax in Australia and Other Measures) Bill 2018 [Provisions], [Submission no. 62], 6 November 2018, p. 4.

\(^{27}\) Ibid., p. 8.

\(^{28}\) Booking.com, Submission to Senate Standing Committee on Economics, Treasury Laws Amendment (Making Sure Multinationals Pay Their Fair Share of Tax in Australia and Other Measures) Bill 2018 [Provisions], [Submission no. 74], 24 December 2018, p. 2.

\(^{29}\) Airbnb, Submission to Senate Standing Committee on Economics, Treasury Laws Amendment (Making Sure Multinationals Pay Their Fair Share of Tax in Australia and Other Measures) Bill 2018 [Provisions], [Submission no. 73], 17 December 2018, p. 2.

\(^{30}\) Expedia Group, Submission to Senate Standing Committee on Economics, Treasury Laws Amendment (Making Sure Multinationals Pay Their Fair Share of Tax in Australia and Other Measures) Bill 2018 [Provisions], [Submission no. 75], 18 January 2019, p. 1.

in the ‘indirect tax zone’\(^\text{32}\) by a supplier not carrying on a business in the indirect tax zone, from the calculation of current and projected GST turnover.

**Item 4 of Schedule 2** provides that the amendments made by Schedule 2 of the Bill apply to supplies where consideration is provided on or after 1 July 2019, or where the invoice for the supply is issued on or after 1 July 2019.

**Schedule 3 – Non-taxable re-importations of refurbished luxury cars**

**Background**

The Luxury Car Tax (LCT) applies to the importation of cars over a certain value. The tax is levied at a rate of 33 per cent on the value in excess of the LCT threshold. The current LCT threshold for 2019–20 is $67,525, or $75,526 for certain fuel efficient cars.\(^\text{33}\)

In the 2018–19 Budget, the Government announced that the luxury car tax (LCT) would no longer apply when cars are exported overseas for refurbishment and then reimported into Australia with no change in ownership.\(^\text{34}\)

**Position of major interest groups**

Automotive groups such as the Australian Automotive Aftermarket Association, the Australasian New Car Assessment Program and the Australian Historic Vehicle Interest Group welcomed the proposed amendments as a small step, but have also argued that the LCT should be abolished altogether.\(^\text{35}\)

The Motor Trades Association of Australia (MTAA) does not support the Bill, as it considers that removing the LCT for refurbishments overseas may discourage refurbishments being undertaken in Australia:

> MTAA advocates for a tax system that promotes the use of services provided by the Australian automotive industry including vehicle modification and refurbishment. MTAA opposes any tax concessions (such as the LCT concessions proposed) that may promote vehicle importers to use automotive modification and refurbishment services provided overseas.\(^\text{36}\)

The MTAA also supports the removal of the LCT in its entirety.\(^\text{37}\)

**Key issues and provisions**

The Bill inserts **proposed subsection 7-20(1A)** of the *A New Tax System (Luxury Car Tax) Act 1999*, which provides that an importation of a luxury car tax is a ‘non-taxable re-importation’ if it satisfies the following criteria:

- the car is exported from the indirect tax zone and reimported into the indirect tax zone

\(^{32}\) ‘Indirect tax zone’ is defined at section 195-1 of the *A New Tax System (Goods and Services Tax) Act 1999* as Australia. However, it excludes external territories, offshore areas for the purpose of the *Offshore Petroleum and Greenhouse Gas Storage Act 2006* and the Joint Petroleum Development Area.

\(^{33}\) Australian Tax Office (ATO), *Luxury car tax rate thresholds*, ATO website.


\(^{37}\) Ibid.
• the car has been subject to any treatment, industrial processing, repair, renovation, alteration or any other process since its export and
• the ownership of the car did not change in the period between export and after re-importation.

The impact of this proposed provision would be that re-importations of refurbished luxury cars would no longer be subject to LCT.