THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

TAX LAWS AMENDMENT (COMBATING MULTINATIONAL TAX AVOIDANCE) BILL 2015

EXPLANATORY MEMORANDUM

(Circulated by the authority of the Treasurer, the Hon J. B. Hockey MP)
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### Glossary

The following abbreviations and acronyms are used throughout this explanatory memorandum.

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Definition</th>
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<tbody>
<tr>
<td>ATO</td>
<td>Australian Taxation Office</td>
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<tr>
<td>BEPS</td>
<td>Base Erosion and Profit Shifting</td>
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<tr>
<td>BEPS Action Plan</td>
<td>The G20 and Organisation for Economic Co-operation and Development’s <em>Action Plan on Base Erosion and Profit Shifting</em></td>
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<td>CbC</td>
<td>Country-by-Country</td>
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<tr>
<td>Commissioner</td>
<td>Commissioner of Taxation</td>
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<td>GST</td>
<td>Goods and services tax</td>
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<tr>
<td>ITAA 1936</td>
<td><em>Income Tax Assessment Act 1936</em></td>
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<td>ITAA 1997</td>
<td><em>Income Tax Assessment Act 1997</em></td>
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<td>OECD</td>
<td>Organisation for Economic Co-operation and Development</td>
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<td>PE</td>
<td>permanent establishment</td>
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<td>TAA 1953</td>
<td><em>Taxation Administration Act 1953</em></td>
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<td>Transfer Pricing Guidelines</td>
<td><em>Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations</em></td>
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General outline and financial impact

Significant global entity

Schedule 1 to this Bill amends the Income Tax Assessment Act 1997 to include a standard and centralised set of concepts that can be used to determine whether an entity is a ‘significant global entity’.

The concept of a ‘significant global entity’ is used in all three measures in this Bill as part of the ‘combating multinational tax avoidance’ package announced in the 2015-16 Budget.

*Date of effect:* These amendments commence at Royal Assent.

*Proposal announced:* These amendments will introduce a central concept that is used in each of the measures in the ‘combating multinational tax avoidance’ package that was announced on 12 May 2015 as part of the 2015-16 Budget.

*Financial impact:* Nil.

*Human rights implications:* This Schedule does not raise any human rights issues. See Statement of Compatibility with Human Rights — Chapter 2, paragraphs 2.38 to 2.42.

*Compliance cost impact:* Nil. This Schedule introduces a new concept into the tax law. Any compliance costs associated with the measures that use this new concept are articulated in the other Chapters of the Explanatory Memorandum.

Multinational anti-avoidance law

Schedule 2 to this Bill amends the anti-avoidance provisions in the Income Tax Assessment Act 1936 to introduce the multinational anti-avoidance law.

The multinational anti-avoidance law is designed to counter the erosion of the Australian tax base by multinational entities using artificial or contrived arrangements to avoid the attribution of business profits to Australia through a taxable presence in Australia.
Date of effect: This measure applies on or after 1 January 2016 in connection with a scheme, whether or not the scheme was entered into, or was commenced to be carried out, before that day.

However, the measure does not apply in relation to tax benefits that a taxpayer derives before 1 January 2016.

Proposal announced: This measure was announced by the Treasurer on 11 May 2015 and formed part of the ‘combating multinational tax avoidance’ package in the 2015-16 Budget.

Financial impact: This measure has these revenue implications:

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* unquantifiable

Human rights implications: This Schedule does not raise any human rights issues. See Statement of Compatibility with Human Rights — Chapter 3, paragraphs 3.120 to 3.124.

Compliance cost impact: This measure has a compliance cost impact of $9.2 million each year. This cost has been fully offset within the portfolio.

Summary of regulation impact statement

Regulation impact on business

Impact: This measure has a compliance cost impact of $9.2 million each year. This cost has been fully offset within the portfolio.

Main points:

- Multinational tax avoidance undermines the integrity of international and domestic tax systems.

- The multinational anti-avoidance law will prevent multinationals who sell to Australian customers from using artificial arrangements in order to avoid paying tax in Australia.

- This will make Australia’s tax system less vulnerable to multinational tax avoidance, increasing confidence in the integrity of the system.
• Taxpayers with structures at risk of falling within the scope of the new law are likely to seek advice on its potential application and, if at risk of being caught, may reassess the tax consequences of their existing structure or restructure their operations to remove the artificiality. There may be substantial upfront compliance costs associated with such activities.

  - The multinational anti-avoidance law is targeted at 30 large multinational companies, though up to 100 companies may need to review their arrangements to make sure they comply with the new law.

• Any multinationals that are found to be avoiding Australian tax under the new law will have to pay back the tax they owe (plus interest) and face penalties of up to 100 per cent of the tax owed. This result is appropriate given the tax avoidance purpose of their actions.

**Stronger penalties to combat tax avoidance and profit shifting**

Schedule 3 to this Bill amends the *Taxation Administration Act 1953* to double the penalties imposed on significant global entities that enter into tax avoidance or profit shifting schemes. The amendments will not apply to taxpayers that adopt a tax position that is reasonably arguable.

**Date of effect:** This measure applies to scheme benefits that an entity gets in relation to an income year commencing on or after 1 July 2015 (regardless of when the scheme was entered into or carried out).

**Proposal announced:** This measure was announced by the Treasurer on 11 May 2015 and formed part of the ‘combating multinational tax avoidance’ package in the 2015-16 Budget.

**Financial impact:** This measure has these revenue implications:

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**Human rights implications:** This Schedule does not raise any human rights issues. See *Statement of Compatibility with Human Rights* — Chapter 4, paragraphs 4.18 to 4.21.

**Compliance cost impact:** This measure does not have a compliance cost impact.
Summary of regulation impact statement

Regulation impact on business

Impact: This measure does not have a compliance cost impact.

Main points:

• Substantially increasing the penalties for large companies will ensure a better balance between the financial consequences of tax avoidance and the potential gains for multinational companies.

• Given the consequences of non-compliance will be higher, some companies may take conservative tax positions. As a result, there may be an increase in primary tax compliance.

• An increase in the penalties for large companies may also increase community confidence in the tax system, countering the perception that small and medium enterprises shoulder an unfair burden.

• There are no direct regulatory costs for business as the primary tax obligations will not change.

Country-by-Country reporting

Schedule 4 to this Bill implements Action 13 of the G20 and Organisation for Economic Co-operation and Development’s Action Plan on Base Erosion and Profit Shifting, which concerns transfer pricing documentation and Country-by-Country reporting, into Australian domestic law.

Date of effect: Schedule 4 to this Bill applies to income years commencing on or after 1 January 2016.

Proposal announced: This measure was announced by the Treasurer on 11 May 2015 and formed part of the ‘combating multinational tax avoidance’ package in the 2015-16 Budget.

Financial impact: This measure has these revenue implications:

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</table>
Human rights implications: This Schedule does not raise any human rights issues. See Statement of Compatibility with Human Rights — Chapter 5, paragraphs 5.40 to 5.43.

Compliance cost impact: This measure has a compliance cost impact of $14.05 million each year. This cost has been fully offset within the portfolio.

Summary of regulation impact statement

Regulation impact on business

Impact:

This measure has a compliance cost impact of $14.05 million each year. This cost has been fully offset within the portfolio.

Main points:

- Information asymmetries between taxpayers and tax authorities can make it difficult for tax authorities to enforce laws designed to prevent tax avoidance and profit shifting, such as transfer pricing rules.

- To address this, the Organisation for Economic Cooperation and Development has developed new transfer pricing documentation standards (referred to as Country-by-Country reporting).

- Country-by-Country reporting will provide the Australian Taxation Office (ATO) with a global picture of how multinationals operate. This will allow the ATO to better assess transfer pricing risks and allocate audit resources more efficiently.

- More effective administrative scrutiny may prompt multinationals to take less aggressive tax positions.

- Australia’s support for OECD’s Country-by-Country reporting initiative will encourage other countries to adopt the new reporting requirements maximising the benefits of a more transparent international tax system.

- Compiling and reporting the information required will require upfront system changes and ongoing resources. However, this would be limited to between 800 and 1,200
multinationals, including 30 to 50 Australian-headquartered taxpayers.

- The affected taxpayers are quite sophisticated and the majority of information required to be completed in the reports will be relatively simple to extract once appropriate systems are in place.
Chapter 1
Introduction

1.1 Corporate tax avoidance is of significant concern both on a domestic and global scale. Governments around the world have been wrestling with multinational taxation, and Australia is taking a leading role in the push for foreign businesses to pay their fair share.

1.2 As the G20 President in 2014, Australia led progress on the Organisation for Economic Co-operation and Development’s (OECD’s) Base Erosion and Profit Shifting (BEPS) Action Plan to ensure multinational entities pay the right amount of tax.

1.3 The vast majority of Australians do the right thing, and the tax system is built on trust and voluntary compliance; however, some multinational entities engage in deliberate tax avoidance, exploiting legal loopholes to pay less tax than the law intended.

1.4 To the extent this erodes Australia’s tax base, this may mean that individuals and other businesses face higher rates of tax in the future, hurting the economy and jobs.

1.5 The Government is committed to the two year G20/OECD BEPS project which aims to restore fairness in the international tax system and ensure that entities pay tax where they have earned their profits.

1.6 The 2015-16 Budget included a package of measures to combat multinational tax avoidance, which included action on four of the 2014 BEPS recommendations. Specifically:

- implementing the OECD’s country-by-country reporting regime from 1 January 2016;
- incorporating the OECD’s treaty abuse rules into our treaty practice;
- asking the Board of Taxation to consult on the implementation of the OECD’s anti-hybrid rules; and
- the Australian Taxation Office (ATO) commencing exchange of information on preferential tax rulings.
1.7 While the OECD work is essential, immediate action is also required to ensure that Australia’s tax laws are fit to deal with the most egregious tax avoidance arrangements.

1.8 To this end, the 2015-16 Budget package also included a number of domestic measures, including:

- introducing a multinational anti-avoidance law to strengthen our existing tax avoidance laws;

- improving the integrity of the tax system by ensuring the goods and services tax (GST) applies to digital products and services imported by Australian consumers; and

- doubling penalties for large companies engaging in tax avoidance and profit shifting.

1.9 This Bill introduces one of the OECD’s 2014 BEPS recommendations described above – country-by-country reporting – and two of the domestic measures – the multinational anti-avoidance law and increased penalties.
Chapter 2
Significant global entity

Outline of chapter

2.1 Schedule 1 to this Bill amends the *Income Tax Assessment Act 1997* (ITAA 1997) to include a standard and centralised set of concepts that can be used to determine whether an entity is a ‘significant global entity’.

2.2 The concept of a ‘significant global entity’ is used in all three measures in this Bill as part of the ‘combating multinational tax avoidance’ package announced in the 2015-16 Budget.

2.3 All references to legislative provisions in this Chapter are references to the ITAA 1997, unless otherwise stated.

Context of amendments

2.4 In the 2015-16 Budget, the Government announced a package of measures designed to address tax avoidance and profit-shifting schemes entered into by large multinationals. Specifically, the measures target entities that are part of a multinational group earning significant amounts of income worldwide – AU$1 billion or more annually. Three of the Budget measures — the multinational anti-avoidance law, country-by-country reporting and, increased penalties to combat tax avoidance and profit-shifting — apply to such entities.

2.5 The measures are targeted at these entities because large multinationals have the greatest opportunities to avoid tax through offshore activities and represent the highest risk to Australia’s tax base. This is consistent with the Government’s commitment to deregulation and small business, and with the recommended approach of the OECD on country-by-country reporting.

2.6 In order to adequately define these types of entities, it is necessary to introduce a new concept into the tax law that can give clarity to taxpayers about whether they are within the scope of the measures to which this definition applies. Existing concepts in the tax law do not adequately capture such entities.
2.7 Division 960 provides a list of general concepts and topics that relate to provisions across the tax law. Inserting the new concept into Division 960 will allow for each measure in this Bill (and any future measures) to reference a centralised definition of ‘significant global entity’.

Summary of new law

2.8 Schedule 1 to this Bill amends the ITAA 1997 to include a standard and centralised set of concepts that can be used to determine whether an entity is a ‘significant global entity’.

2.9 An entity is a ‘significant global entity’ for a period if it has annual global income of AU$1 billion or more.

2.10 An entity may also be a significant global entity if it is a member of a group of entities that are consolidated for accounting purposes as a single group and the global parent entity of the group has annual global income for the period of AU$1 billion or more.

Comparison of key features of new law and current law

<table>
<thead>
<tr>
<th>New law</th>
<th>Current law</th>
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<tr>
<td>A new concept will be introduced into the tax law that can be used to determine whether an entity is a ‘significant global entity’.</td>
<td>No equivalent concept exists in the tax law.</td>
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Detailed explanation of new law

Determining whether an entity is a ‘significant global entity’

2.11 An entity is a ‘significant global entity’ for a period if it is a ‘global parent entity’ with ‘annual global income’ of AU$1 billion or more. [Schedule 1, item 3, subsection 960-555(1)]

2.12 It may also be a significant global entity if it is a member of a group of entities that are consolidated for accounting purposes as a single group, and the global parent entity of the group has annual global income for the period of AU$1 billion or more. [Schedule 1, item 3, subsection 960-555(2)]
Global parent entity

2.13 A ‘global parent entity’ is an entity that is not controlled by another entity according to accounting principles, or, where accounting principles do not apply in relation to the entity, commercially accepted principles related to accounting. [Schedule 1, item 3, section 960-560]

2.14 A global parent entity will usually be a member of a group of entities where the global parent entity is the one that is not controlled by any of the others. Subsidiaries of the global parent may be located in other jurisdictions. However, it is possible for a global parent entity to be a single entity that does not control any other entities.

Annual global income

2.15 If a global parent entity is a member of a group of entities that are consolidated for accounting purposes as a single group, the global parent entity’s ‘annual global income’ for a period is the total of the annual global income amounts of the consolidated group, as shown in total or disclosed in parts in its latest ‘global financial statements’ for that period. [Schedule 1, item 3, paragraph 960-565(a)]

2.16 Otherwise, a global parent entity’s annual global income for a period is the total annual income of the entity as shown in total or disclosed in parts in its latest global financial statements for that period. [Schedule 1, item 3, paragraph 960-565(b)]

Example 2.1: Calculating annual global income

Hent Inc. is a multinational corporation and has global income, as reported in its global financial statements for the year ended 31 December 2017, of $AU800 million (as translated into Australian dollars).

This same group makes a global acquisition in the year ended 31 December 2018 and as a result reports global income of $AU1.3 billion in that year (as translated into Australian dollars).

For the year ended 31 December 2017, Hent Inc. will not meet the annual global income test and as such will not be a significant global entity for this year.

In the year ended 31 December 2018, the annual global income test is met and as such Hent Inc. will be a significant global entity for this year.
Example 2.2: Calculating annual global income

Blackbellamy Pty Ltd is a local Australian subsidiary of the large multinational Blackbellamy Worldwide Inc.

In the 2018-19 income year, Blackbellamy Pty Ltd reports $AU60 million of total income as part of the financial statements it is required to prepare under Australian law.

However, in the 2018-19 income year the annual global income of Blackbellamy Worldwide Inc. and its consolidated group, as shown in their global financial statements, is $AU1.6 billion (as translated into Australian dollars).

As Blackbellamy Pty Ltd is a member of a consolidated group with annual global income of over $AU 1 billion, it will be a significant global entity for the 2018-19 income year.

Foreign currency conversion

2.17 When calculating the annual global income of an entity, it may be necessary to translate amounts into Australian currency.

2.18 Under these new provisions, the currency conversion is completed on the basis of the average exchange rate for the period for which the statements are prepared. The method of working out the average exchange rate reflects the existing method in item 1.3 of Schedule 2 to the Income Tax Assessment Regulations 1997. [Schedule 1, item 1, subsections 960-50(7A) and (7B) and item 2, subsection 960-50(9)]

Example 2.3: Conversion of income amounts into Australian dollars

Murphé Ltd is the global parent entity of a large multinational group and prepares financial statements in a foreign currency. For the year ended 30 September 2017 the annual global income for Murphé Ltd, which includes the total annual income of all members of its group, was reported as $F800 million (where $F is the currency in the jurisdiction in which Murphé Ltd is resident).

In order to test whether the annual global income test is satisfied, the foreign currency is required to be converted to Australian dollars. The average exchange rate for the period for which the statements are prepared (1 October 2016 – 30 September 2017) is $F1 to AU$2.

The annual global income would be greater than $AU1 billion and, as such, Murphé Ltd, and any other entity within its group, will be a significant global entity.
2.19 As part of this currency conversion method, the entity must obtain exchange rates to develop an average exchange rate for the period. This involves getting exchange rates from one or more sources that are not associates of the entity or, as an alternative, from sources specified by the Commissioner of Taxation (Commissioner) in a notice to the entity. To provide additional clarity, the amendments state that this notice from the Commissioner is not a legislative instrument. [Schedule 1, item 1, subsection 960-50(7C)]

**Commissioner’s determination of the annual global income**

2.20 If global financial statements have not been prepared for a period in relation to a global parent entity, the Commissioner may make a determination on the basis of information that is available, where the Commissioner reasonably believes that the entity’s annual global income would have been AUS1 billion or more. This allows for administrative flexibility where a global financial statement is not required to have been prepared for a global parent entity. [Schedule 1, item 3, subsection 960-555(3)]

2.21 Allowing the Commissioner to make this determination, will ensure that the measures apply to all entities that are part of a multinational group with annual global income of AUS1 billion or more even where global financial statements have not been prepared.

2.22 If the Commissioner makes a determination that an entity is a significant global entity, the Commissioner must then give a notice of the determination to the global parent entity or to an entity that becomes a significant global entity as a result of the Commissioner’s determination. [Schedule 1, item 3, subsection 960-555(3)]

2.23 To provide clarity, the Commissioner’s determination is not a legislative instrument. [Schedule 1, item 3, subsection 960-555(6)]

**Objecting to the Commissioner’s determination**

2.24 Where an entity is dissatisfied with the Commissioner’s determination that is made in relation to the entity, the determination is reviewable under Part IVC of the *Taxation Administration Act 1953*. [Schedule 1, item 3, subsection 960-555(4)]

2.25 However, there are special rules that apply to the right of objection on the Commissioner’s determination where the entity has also objected to an income tax assessment, relating to the entity, with regard to the application of section 177DA of the *Income Tax Assessment Act 1936* (ITAA 1936) (the multinational anti-avoidance law, detailed in Chapter 3 of the Explanatory Memorandum). [Schedule 1, item 3, subsection 960-555(5) and item 5, section 14ZVA of the *Taxation Administration Act 1953*]
2.26 Where there has been a taxation objection against an assessment involving section 177DA of the ITAA 1936, an objection under subsection 960-555(4) against a determination will not apply in respect to that assessment. However, an objection under subsection 960-555(4) against a determination will apply for purposes other than the assessment involving section 177DA.

2.27 Thus, a taxpayer who is unsuccessful in a taxation objection against an assessment involving section 177DA of the ITAA 1936 can still object to a determination under subsection 960-555(4), but that objection will only apply for purposes other than the assessment covered by that taxation objection. Alternatively, a taxpayer who is successful in a taxation objection against an assessment involving section 177DA that specifically deals with a Commissioner’s determination will still need to object under subsection 960-555(4) for purposes other than the assessment covered by the taxation objection.

2.28 In addition, section 175 of the ITAA 1936 applies to the Commissioner’s determination in the same way that it applies to an assessment under that Act. [Schedule 1, item 3, subsection 960-555(7)]

2.29 This means that objections against the determination cannot be made with respect to procedural irregularities in the Commissioner’s process of making a determination and must instead be made on substantive grounds.

Global financial statements

2.30 The ‘global financial statements’ of an entity are financial statements that have been prepared in relation to an entity, or that entity and other entities, in accordance with accounting principles and auditing principles.

2.31 If those principles do not apply to the entity, then the global financial statements are financial statements that have been prepared in relation to an entity, or that entity and other entities in accordance with commercially accepted principles relating to accounting and auditing that ensure the statements give a true and fair view of the financial position and performance of that entity (or that entity and the other entities on a consolidated basis). [Schedule 1, item 3, section 960-570]

2.32 ‘Accounting principles’ and ‘auditing principles’ are linked to definitions of ‘accounting standards’ and ‘auditing standards’ in sections 334 and 336 of the Corporations Act 2001. These definitions refer to standards set by the Australian Accounting Standards Board and the Auditing and Assurance Standards Board. [Schedule 1, item 3, subparagraph 960-570(a)(i)]
2.33 The concept of ‘commercially accepted’ principles is based on paragraph 432(1)(c) of the ITAA 1936. Commercially accepted auditing and accounting principles would usually be the standards in use in the country in which an entity is resident or carries on its principal business activities. These standards are typically developed and enforced by the relevant accounting and auditing authorities in each country. In addition, the standards must ensure that the statements provide a true and fair view of the entity’s financial position. \([\text{Schedule 1, item 3, subParagraph 960-570(a)(ii)}]\)

2.34 The global financial statement that is relevant for determining whether an entity is a significant global entity is the statement that has been prepared for a period ending no later than the end of the relevant period, and ending no earlier than 12 months before the start of the relevant period. \([\text{Schedule 1, item 3, Paragraph 960-570(b)}]\)

2.35 Where there are multiple statements that satisfy paragraph 960-570(a), it is the statements for the most recent period that are to be used. \([\text{Schedule 1, item 3, Paragraph 960-570(b)}]\)

Consequential amendments

2.36 Consequential amendments are made to subsection 995-1(1) to include definitions of ‘annual global income’, ‘global financial statements’, ‘global parent entity’ and ‘significant global entity’. \([\text{Schedule 1, item 4, Subsection 995-1(1)}]\)

Application and transitional provisions

2.37 These amendments commence on Royal Assent.
STATEMENT OF COMPATIBILITY WITH HUMAN RIGHTS

Prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011

Significant global entity

2.38 This Schedule is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the Human Rights (Parliamentary Scrutiny) Act 2011.

Overview

2.39 Schedule 1 to this Bill amends the ITAA 1997 to include a standard and centralised set of concepts that can be used to determine whether an entity is a ‘significant global entity’.

2.40 The concept of a ‘significant global entity’ is used in all three measures in this Bill as part of the ‘combating multinational tax avoidance’ package announced in the 2015-16 Budget.

Human rights implications

2.41 This Schedule does not engage any of the applicable rights or freedoms as it is simply a set of concepts inserted into the tax law to define a type of entity to which other measures apply.

Conclusion

2.42 This Schedule is compatible with human rights as it does not raise any human rights issues.
Chapter 3
Multinational anti-avoidance law

Outline of chapter

3.1 Schedule 2 to this Bill amends the anti-avoidance provisions in the Income Tax Assessment Act 1936 (ITAA 1936) to introduce the multinational anti-avoidance law.

3.2 The multinational anti-avoidance law is designed to counter the erosion of the Australian tax base by multinational entities using artificial or contrived arrangements to avoid the attribution of business profits to Australia through a taxable presence in Australia.

3.3 All references to legislative provisions in this Chapter are references to the ITAA 1936, unless otherwise stated.

Context of amendments

3.4 This measure will ensure that multinational entities cannot use complex, contrived and artificial schemes to escape paying Australian tax. It targets those multinational entities that:

- avoid a taxable presence by undertaking significant work in Australia in direct connection to Australian sales but booking their revenue offshore; and
- have a principal purpose of avoiding tax in Australia or reducing their foreign tax liability.

3.5 Australia’s current general anti-avoidance rule in Part IVA requires that schemes have been entered into for the sole or dominant purpose of obtaining an Australian tax benefit. Multinational entities may argue that their global arrangements are entered into for the purpose of avoiding tax in other countries where the Australian tax benefit is relatively small. For example, this might be argued where the Australian sales of multinational entities are a relatively small part of their global business.

3.6 The multinational anti-avoidance law will involve a lower threshold test to be met of ‘one or more of the principal purposes’ and it will allow foreign tax purposes to be included in that consideration.
3.7 The new law will clarify that a limited and clearly egregious set of circumstances involving sales to Australian customers by foreign multinationals are considered to be tax avoidance.

**Summary of new law**

3.8 Schedule 2 to this Bill amends anti-avoidance rules in the income tax law to negate certain tax avoidance schemes used by multinational entities to artificially avoid the attribution of profits to a permanent establishment in Australia.

3.9 The new measure does not limit the application of the existing general anti-avoidance rule in Part IVA, and accordingly section 177D can still apply to schemes involving permanent establishments.

**Which entities will be subject to the new measure?**

3.10 To reduce compliance costs and provide certainty, this measure only applies to foreign entities that are ‘significant global entities’ (as described in Chapter 2 of the Explanatory Memorandum).

**What schemes will be captured by the measure?**

3.11 Broadly speaking, this measure will target schemes where under, or in connection with, the scheme:

- a foreign entity derives income from the making of certain supplies to Australian customers;

- there is an entity in Australia (that is an associate of, or commercially dependent on, the foreign entity) supporting the making of those supplies; and

- the foreign entity avoids the income derived from the supply being attributable to a permanent establishment of that foreign entity in Australia.

3.12 For the multinational anti-avoidance law to apply to a particular scheme, it must be concluded that the scheme was entered into or carried out for a particular purpose, consistent with the general framework of Part IVA.

3.13 Specifically, the person, or one of the persons, who entered into or carried out the scheme, must have done so for the principal purpose, or for more than one principal purpose that includes, enabling one or more
taxpayers to obtain a tax benefit, or both to obtain a tax benefit and to reduce or defer (beyond a reasonable period) one or more of the taxpayers’ liabilities to tax under a foreign law in connection with the scheme.

**What will the tax outcome be where the measure applies?**

3.14 Where a scheme is captured by the multinational anti-avoidance law, the Commissioner of Taxation (Commissioner) has the power to make a determination under Part IVA and, based on a reasonable alternative postulate, apply the tax rules as if the foreign entity had been making a supply through an Australian permanent establishment.

3.15 The quantum of the tax benefit obtained under the scheme will depend on the facts and circumstances of the case but is likely to include the ordinary and statutory income from the supply that would have been attributable to an Australia permanent establishment of the foreign entity, subject to any compensating adjustments allowing for deductions.

3.16 The quantum of the tax benefit obtained would also take into account obligations arising (for the relevant taxpayer or another taxpayer) under Australia’s royalty and interest withholding tax rules.

**Comparison of key features of new law and current law**

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<th>Current law</th>
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<td>A taxpayer who obtains a tax benefit under a scheme (involving the avoidance of the attribution of income to an Australian permanent establishment) that was entered into or carried out for the principal purpose of, or for more than one principal purpose that includes a purpose of obtaining a tax benefit or both obtaining a tax benefit and reducing or deferring a foreign tax liability under the scheme, may have their tax benefit cancelled by the Commissioner under Part IVA. This would apply only to a taxpayer if the scheme relates to a foreign entity that is a ‘significant global entity’. The current law position will also continue to apply to all taxpayers.</td>
<td>A taxpayer who obtains a tax benefit under a scheme (including involving the avoidance of the attribution of income to an Australian permanent establishment) that was entered into or carried out for the sole or dominant purpose of obtaining a tax benefit under that scheme, may have their tax benefit cancelled by the Commissioner under Part IVA.</td>
</tr>
</tbody>
</table>
Detailed explanation of new law

Which entities will be subject to the new measure?

3.17 This measure will only apply where the foreign entity involved in the scheme is a ‘significant global entity’ for a year of income in which the relevant taxpayer (or another taxpayer) obtains a tax benefit, or reduces or defers a tax liability under a foreign law, in connection with the scheme. [Schedule 2, item 4, paragraph 177DA(1)(c)]

3.18 This measure picks up the new centralised concept of ‘significant global entity’ as defined in section 960-555 of the ITAA 1997. [Schedule 2, item 1, subsection 177A(1) — ‘significant global entity’]

3.19 This means that the measure will not apply to a scheme unless the foreign entity involved in the scheme has, or is part of a global group that has, annual global income in excess of AU$1 billion for the relevant income year.

3.20 Further information about how to determine whether an entity is a ‘significant global entity’ is in Chapter 2 of this Explanatory Memorandum.

What schemes will be captured by the measure?

The structure of the scheme

3.21 The multinational anti-avoidance law will apply to a scheme if under, or in connection with, the scheme:

- a foreign entity makes certain supplies to an Australian customer; [Schedule 2, item 4, subparagraph 177DA(1)(a)(i)]

- activities are undertaken in Australia directly in connection with the supply; [Schedule 2, item 4, subparagraph 177DA(1)(a)(ii)]

- some or all of those activities are undertaken by an Australian entity (or an Australian permanent establishment of an entity) that is an associate of or is commercially dependent on the foreign entity; [Schedule 2, item 4, subparagraph 177DA(1)(a)(iii)]

- the foreign entity derives ordinary or statutory income from the supply; and [Schedule 2, item 4, subparagraph 177DA(1)(a)(iv)]
• some or all of that income is not attributable to an Australian permanent establishment of the foreign entity. [Schedule 2, item 4, subparagraph 177DA(1)(a)(v)]

Supply to an Australian customer

3.22 The supply must be made by the foreign entity to an Australian customer of the foreign entity. [Schedule 2, item 4, subparagraph 177DA(1)(a)(i)]

3.23 An Australian customer means an Australian entity, or an entity that is in Australia and excludes an entity that is a member of the foreign entity’s global group. [Schedule 2, item 1, subsection 177A(1) — ‘Australian customer’]

3.24 This is designed to target schemes that involve supplies to arm’s length Australian customers and exclude supplies between the foreign entity and members of its global group (that is, intra-group supplies).

Example 3.1: Supply made by foreign entity through an Australian subsidiary

A foreign entity sells goods to its Australian subsidiary. The Australian subsidiary then sells the goods to unrelated Australian customers. The income from Australian customers is recognised for tax purposes by the Australian subsidiary.

Because the foreign entity is supplying goods to a related Australian subsidiary, the multinational anti-avoidance law will not apply

Australian entity

3.25 The term ‘Australian entity’ as used in this measure adopts the concept in Part X of the ITAA 1936 (the controlled foreign company rules). [Schedule 2, item 1, subsection 177A(1) — ‘Australian entity’]

3.26 Although the term ‘Australian entity’ is used for the purposes of Part X, the term has been used outside Part X, namely in the thin capitalisation rules (section 25-90 and Division 820 of the ITAA 1997), the taxation of financial arrangements (TOFA) rules (section 230-15 of the ITAA 1997) and the cross-border transfer pricing rules (section 815-5 of the ITAA 1997).

3.27 As per section 336, ‘Australian entity’ means an Australian partnership, an Australian trust or an entity (other than a partnership or trust) that is a ‘Part X Australian resident’.
Australian partnership

3.28 An Australian partnership (as defined in section 337) at a particular time is a partnership that has at least one partner who is an Australian entity at that time.

Australian trust

3.29 An Australian trust (as defined in section 338) at a particular time is a trust:

• where, at any time in the previous 12 months, any trustee of the trust was a Part X Australian resident or the central management and control was in Australia; or

• that was a corporate unit trust or public trading trust at that time.

Part X Australian resident

3.30 Part X Australian resident (as defined in subsection 317(1)), means a resident under subsection 6(1) excluding any Australia resident that is deemed to be a resident of a foreign county under a residency tiebreaker rule in a tax treaty.

Foreign entity

3.31 The term ‘foreign entity’ as used in this measure also adopts concepts in the controlled foreign company rules and is defined in subsection 995-1(1) of the ITAA 1997 as an entity that is not an Australian entity. [Schedule 2, item 1, subsection 177A(1) — ‘foreign entity’]

3.32 The reference to ‘entity’ takes its meaning from section 960-100 of the ITAA 1997 and includes an individual, a body corporate, a body politic, a partnership, any other unincorporated association or body of persons, a trust, a superannuation fund and an approved deposit fund. [Schedule 2, item 1, subsection 177A(1) — ‘entity’]

3.33 In respect to a trust, the trustee of a trust is taken to be an entity consisting of the person who is the trustee, or the persons who are the trustees at any given time.

Supply

3.34 The term ‘supply’ as used in this measure is taken from section 9-10 of the A New Tax System (Goods and Services) Tax Act 1999 and includes, amongst other things, the supply of electronic material, advertising services, downloads, the provision of data, intellectual
property rights, and the right to priority in search functions. \([\text{Schedule 2, item 1, subsection 177A(1) — 'supply']}\]

3.35 However, there are some exclusions from the broad definition of supply that apply for the purposes of this measure. The types of supplies excluded from the concept adopted for this measure include the following (or any combination of two or more of the following):

- the supply of an equity interest in an entity (as defined in subsection 995-1(1) of the ITAA 1997);
- the supply of a debt interest in an entity (as defined in subsection 995-1(1) of the ITAA 1997); and
- the supply of an option to supply an equity or debt interest, or the supply of an option to supply any combination of the above. \([\text{Schedule 2, item 1, subsection 177A(1) — 'supply']}\]

3.36 These supplies have been excluded from this measure as including them could have the unintended consequence of capturing the legitimate structures of offshore capital market participants including foreign investors in Australian shares and debt interests.

**Example 3.2: A supply made by foreign entity to Australian customers**

A foreign entity sells shares in an Australian company to the Australian public through an Initial Public Offering (IPO).

As the supply to Australian customers is a supply of shares, which are equity interests, this would not be a supply that would be caught under the multinational anti-avoidance law.

3.37 The exclusion from the broader definition of supply for the types of supplies listed above only applies for an arrangement solely for that particular supply, or combination of supplies as indicated. It will not apply where the relevant supply is part of a composite supply that includes a supply that is not referred to in the list above (for example, a supply of goods).

**Activities undertaken in Australia are directly connected with the supply**

3.38 For the measure to apply, the scheme must involve activities being undertaken in Australia that are directly connected with the supply to the Australian customers. \([\text{Schedule 2, item 4, subparagraph 177DA(1)(a)(ii)}]\)
3.39 The extent of the direct connection between the activities undertaken in Australia and the supply to the Australian customers that is required to satisfy this element of the scheme will depend on the facts and circumstances of the particular scheme but is intended to be broad. However, indirect connections to the supply to Australian customers will not be sufficient.

3.40 Activities that contribute to bringing about the contract for the supply, such as the building of client relationships, are captured.

Example 3.3: Foreign entity carrying on activities in Australia with no direct connection to the supply

A foreign entity provides goods directly to an unrelated taxpayer in Australia.

There are no activities undertaken in Australia by an associate or commercially dependent entity in direct connection to the supply. The foreign entity communicates directly with customers from its country of residence and the goods are shipped using an independent freight and logistics company.

Because there are no activities being carried on in Australia in direct connection with the supply, the multinational anti-avoidance law does not apply.

Some or all of those activities are undertaken by an entity in Australia that is an associate or commercially dependent on the foreign entity

3.41 Some or all of those activities connected with the supply to the Australian customers need to be undertaken by an Australian entity or undertaken at or through an Australian permanent establishment of an entity. [Schedule 2, item 4, subparagraph 177DA(1)(a)(iii)]

Example 3.4: ‘Fly-in, fly-out’ arrangement

A foreign entity that sells large highly specialised machinery has no associates in Australia and does not have an Australian permanent establishment.

In order to sell machinery to Australian customers, the foreign entity flies two of its employees to Australia for a week to meet with and understand the needs of Australian customers. The foreign entity’s personnel then fly back to the host country to incorporate the information obtained from the meetings in Australia into the development of their product and offering. The arrangement is such that the two employees visiting Australia do not otherwise amount to a permanent establishment in Australia.
The Australian customer purchases the goods directly from the foreign entity. There is no other connection with Australia in relation to the arrangement.

Because there is no Australian entity, or entity in Australia, assisting with the sale, the multinational anti-avoidance law does not apply.

3.42 The measure will only apply to schemes where an Australian entity (or any entity with a permanent establishment in Australia) that is undertaking some or all of this activity is an associate of the foreign entity, or is commercially dependent on the foreign entity. [Schedule 2, item 4, subparagraph 177DA(1)(a)(iii)]

3.43 As a result, schemes are not caught by this measure where, for example, a foreign entity makes a supply through an independent agent or broker.

3.44 The term ‘commercially dependent’ is not defined in the tax law and takes its ordinary meaning. Whether an entity is considered commercially dependent on the foreign entity will depend on the particular facts and circumstances of the relationship.

3.45 Generally, an entity would be considered commercially dependent if they are, in substance, reliant on the foreign entity for their business to operate. This would clearly be the case where the commercially dependent entity is, through legal form, separate from the foreign entity but receives almost all of its business from the foreign entity.

Example 3.5: Entity that is commercially dependent

A foreign entity supplies goods to Australian customers through a legally independent agent; however, the agent acts almost exclusively for the foreign entity. More than 90 per cent of its revenue is derived from commissions paid by the foreign entity.

As such, the agent is commercially dependent on the foreign entity and the multinational anti-avoidance law may apply to this arrangement.

Example 3.6: Entity that is not commercially dependent

A foreign entity supplies services to Australian customers through a legally independent agent.

The agent has a diversified business and acts for multiple foreign suppliers. As such, it is not commercially dependent on the foreign entity’s business and the multinational anti-avoidance law does not apply to this arrangement.
The foreign entity derives ordinary or statutory income from the supply

3.46 For the measure to apply, the scheme must involve a foreign entity deriving ordinary or statutory income from making the supply to the Australian customer. [Schedule 2, item 4, subparagraph 177DA(1)(a)(iv)]

3.47 The existing concepts and interpretation of ‘deriving income’ and ‘constructive receipt’ apply where another entity (normally connected with the foreign entity) receives income from the supply but is not the foreign entity that makes the supply. That is, the foreign entity will still be considered to have derived the income from the supply.

Some or all of that income from the supply is not attributable to an Australian permanent establishment of the foreign entity

3.48 For the measure to apply, some or all of the income derived from the supply by the foreign entity must not be attributable to an Australian permanent establishment of the foreign entity. [Schedule 2, item 4, subparagraph 177DA(1)(a)(v)]

3.49 Where some of the income derived from the supply by the foreign entity is attributable to an Australian permanent establishment of the foreign entity, this measure may still apply. This ensures that a foreign entity is unable to engineer around this measure by having an unreasonably small or nominal amount of income attributable to an Australian permanent establishment where it would otherwise, but for this scheme, have a much larger portion of the income from the supply attributable to its Australian permanent establishment.

3.50 The term ‘Australian permanent establishment’ covers both the treaty definition of ‘permanent establishment’ and the definition in the ITAA 1936. If the foreign entity is resident in a country with which Australia has a tax treaty containing a Permanent Establishment article, that definition of permanent establishment is to be used. Otherwise, the definition of permanent establishment in subsection 6(1) is to be used. [Schedule 2, item 1, subsection 177A(1) — ‘Australian permanent establishment’]

The purpose test

3.51 The measure applies a purpose test that is satisfied if it would be concluded, having regard to certain matters (discussed below at paragraph 3.66), that the scheme was entered into or carried out for the principal purpose of, or for more than one principal purpose that includes the purpose of, enabling a taxpayer (or taxpayers) to obtain a tax benefit or obtain a tax benefit and reduce foreign tax liabilities in connection with the scheme. [Schedule 2, item 4, paragraph 177DA(1)(b)]
3.52 The required purpose must be established objectively based on an analysis of how the scheme was implemented, what the scheme actually achieved as a matter of substance or reality as distinct from legal form (that is, its end effect), and the nature of any connection between the taxpayer and other parties. The subjective motives of participants in the scheme are irrelevant.

3.53 In coming to a conclusion about whether the purpose test is satisfied, regard is to be had to certain matters that are detailed in subsection 177D(2), and the additional matters, specific to this measure, that are further described at paragraph 3.72. [Schedule 2, item 4, subsection 177DA(2)]

3.54 Consistent with the current purpose test for the general anti-avoidance rule in subsection 177D(1), it is the purpose of the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme that is assessed under section 177DA. Where a person acts on professional advice, it may be appropriate, in certain circumstances, to attribute the objective purpose of the professional adviser to the person.¹

3.55 The person who entered into or carried out the scheme or any part of the scheme does not have to be the same person as the taxpayer who obtains the tax benefit, or both obtains the tax benefit and reduces or defers a foreign tax liability in connection with the scheme.

3.56 However, the purpose test in this measure differs in two critical ways from the purpose test for the general anti-avoidance rule in subsection 177D(1):

- the threshold is lowered from a ‘sole and dominant purpose’ to a ‘principal purpose’ or ‘one of multiple principal purposes’; and

- in addition to being satisfied by a purpose of obtaining an Australian tax benefit (as defined in section 177C), the test may also be satisfied by a combined purpose of obtaining an Australian tax benefit and reducing (or deferring) a foreign tax liability.

¹ See for example the arguments raised in previous cases such as Commissioner of Taxation v Consolidated Press Holdings Ltd [2001] HCA 32, [95].
‘Principal purpose’

3.57 The ‘principal purpose or more than one principal purpose’ threshold is lower than the ‘sole or dominant purpose’ threshold, which is used in subsection 177D(1). The relevant principal purpose need not be the sole or dominant purpose of a person or persons who entered into or carried out the scheme, but must be one of the main purposes, having regard to all the relevant facts and circumstances.

3.58 This recognises that a scheme or part of a scheme may be entered into or carried out for a number of purposes, some or all of which are principal purposes. The scheme will be caught under s177DA as long as one of those principal purposes satisfies the tax benefit requirements of the principal purpose test.

3.59 These new thresholds capture the language used in the 2014 OECD report titled ‘Preventing the Granting of Treaty Benefits in Inappropriate Circumstances’\(^2\). The report (as discussed at pages 11-12 of the Executive Summary and pages 66-74 of the main report) aims to reduce or address treaty abuse through an anti-abuse rule based on ‘one of the principal purposes of any arrangements or transactions’. That is, obtaining a treaty benefit need only be one of the principal purposes of an arrangement or transaction under the new threshold.

Obtaining a tax benefit or reducing (or deferring) liability to foreign tax

3.60 The concept of a tax benefit obtained in connection with a scheme is defined in section 177C. This section specifies a range of tax benefits in existence under the Australian income tax law.

3.61 Under this measure, it is sufficient that there was a purpose of obtaining the tax benefit and that this purpose, combined with another purpose of reducing liability to tax under a foreign law, amounted to the principal purpose or one of the principal purposes. This means that a principal purpose of reducing a foreign tax liability that included a purpose of obtaining a tax benefit (as per section 177C) would satisfy the purpose test. \(\text{[Schedule 2, item 4, paragraph 177DA(1)(b)]}\)

3.62 The concept of reducing liability to tax under a foreign law is specifically included to ensure that the purpose test can be satisfied even if the Australian tax benefit obtained is relatively minor compared to the reduction of a tax liability under a foreign law.\(^3\)

3.63 Such an approach is necessary as a common (but not essential) feature of the arrangements to which the multinational anti-avoidance law is intended to apply involves a purpose of reducing liabilities to tax under foreign laws, in addition to obtaining an Australian tax benefit.

3.64 The term ‘tax under a foreign law’ embraces tax liabilities under both national and sub-national foreign laws, and extends beyond income tax liabilities. [Schedule 2, item 4, paragraph 177DA(1)(b)]

3.65 Moreover, a deferral of a foreign tax liability is treated as if it were a reduction of the foreign tax liability. The inclusion of such a provision is necessary in order to address situations where an entity may be avoiding a foreign tax liability by deferring it beyond a reasonable period, taking into account commercial grounds. [Schedule 2, item 4, subsection 177DA(3)]

**Having regard to certain matters**

3.66 In coming to a conclusion about the purpose test, it is necessary that regard is had to a number of matters. These factors include, but are not limited to, certain matters which look at how the scheme was implemented, what it achieved as a matter of substance or reality (that is, its end effect) and the nature of any connection between the taxpayer and other parties.

3.67 In arriving at this conclusion, the Commissioner must have regard to all of the matters referred to in subsection 177D(2) and a number of specific matters that are particularly relevant to this measure. [Schedule 2, item 4, subsection 177DA(2)]

3.68 This does not mean that each of those matters must point to the necessary purpose. It is the evaluation of all of these matters, separately or taken together, that determines whether the purpose test is satisfied.

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\(^3\) See for example the arguments raised in previous cases such as *Noza Holdings Pty Ltd v Commissioner of Taxation* [2011] FCA 46.
Matters under subsection 177D(2) – general anti-avoidance rule

3.69 The specific matters to consider include those in subsection 177D(2). These factors apply for the purpose test under the general anti-avoidance rule as well as under the multinational anti-avoidance law. [Schedule 2, item 4, paragraph 177DA(2)(a)]

3.70 The matters in subsection 177D(2) are as follows and have regard to:

- the manner in which the scheme was entered into or carried out;
- the form and substance of the scheme;
- the time at which the scheme was entered into and the length of the period during which the scheme was carried out;
- the result in relation to the operation of this Act that, but for this Part, would be achieved by the scheme;
- any change in the financial position of the relevant taxpayer that has resulted, will result, or may reasonably be expected to result, from the scheme;
- any change in the financial position of any person who has, or has had, any connection (whether of a business, family or other nature) with the relevant taxpayer, being a change that has resulted, will result or may reasonably be expected to result, from the scheme;
- any other consequence for the relevant taxpayer, or for any person referred to in the dot point above, of the scheme having been entered into or carried out; and
- the nature of any connection (whether of a business, family or other nature) between the relevant taxpayer and any person referred to in the dot points above.

3.71 The Commissioner will have regard to these matters in order to conclude if there is a principal purpose of obtaining a tax benefit, or both obtaining a tax benefit and reducing a liability to tax under a foreign law.

Additional matters for the multinational anti-avoidance law

3.72 For the purposes of the multinational anti-avoidance law, to the extent applicable, regard must also be had to two additional matters. These additional matters require the consideration of factors that are more
specific to the kinds of schemes intended to be caught by this measure. [Schedule 2, item 4, paragraphs 177DA(2)(b) and (c)]

3.73 This does not mean that each of the additional matters will always apply, particularly where there is insufficient information to determine whether or to what extent they are relevant. Further, the Commissioner is only under an obligation to consider a matter in paragraph 177DA(2)(c) to the extent that information relevant to that matter is available to the Commissioner.

Having regard to the activities undertaken by different entities that contribute to bringing about the Australian supply

3.74 The first additional matter for the measure requires that regard must be had to the extent to which the activities that contribute to bringing about the contract for the supply are performed, and are able to be performed, by:

• the foreign entity;

• an entity described in subparagraph 177DA(1)(a)(iii) (Australian-based entity); or

• any other entities. [Schedule 2, item 4, paragraph 177DA(2)(b)]

3.75 The reference to ‘any other entities’ will allow the Commissioner to have regard to the activities of entities that are linked to the scheme, including situations where there are multiple foreign entities or multiple Australian-based entities involved in the scheme.

3.76 This additional matter requires the Commissioner to look at the nature of activities that led to the conclusion of the contract for the supply and which entity conducts them. As part of this, consideration should be given to the differences (if any) between how the foreign entity interacts with the Australian customers in relation to the contract, and how the Australian-based entity and any other entities interact with those customers in relation to the contract.

3.77 This additional matter draws the Commissioner’s attention to contrivance with respect to the way in which the activities are divided between the relevant entities. In particular, the extent to which the entity with which the contract is concluded carries out the activities required to obtain the contract will be considered.
3.78 It will also draw the Commissioner’s attention to contrivance where it is clear that an entity would not have the capacity to perform certain activities themselves as part of the supply. For example, a foreign entity that has no senior staff would find it difficult to establish that it has the capacity to negotiate and conclude contracts even if it purports to do so.

3.79 This additional matter has the effect that schemes are more likely to be caught where it appears that activities have been split in such a way so as to deliberately fall short of constituting an Australian permanent establishment.

**Example 3.6: Operation of the principal purpose test, having regard to matter in paragraph 177DA(2)(b)**

Revenue from Australian sales is returned to Berksy Ltd which is a multinational corporation that is resident in Country H.

Berksy Ltd has a significant number of employees that work with an Australian associate and Australian customers to establish a business case for Berksy Ltd’s products and communicate the group’s global price list.

Berksy Ltd’s employees also perform credit checks on Australian customers. Berksy Ltd also has senior operational employees that actively work with its legal team to negotiate any non-standard terms or discounts with customers on an ongoing basis. Berksy Ltd has sufficient employees to perform these activities at the outset and on an ongoing basis.

The activities undertaken by the Australian associate, by comparison, are limited to identifying potential customers and communicating standard price lists. The employees of the Australian associate are not involved in creating and recommending business cases and product solutions to Australian customers, or negotiating contractual terms with Australian customers.

Having regard to paragraph 177DA(2)(b), Berksy Ltd appears to have the capacity to negotiate and conclude contracts. The consideration of this factor, along with the other factors prescribed in subsection 177DA(2), may show that Berksy Ltd did not have a principal purpose of obtaining a tax benefit or both obtaining a tax benefit and reducing a foreign tax liability.

**Having regard to the result, in relation to the operation of a foreign tax law, that the scheme would achieve**

3.80 The second additional matter in this measure requires consideration of the result, in relation to the operation of any foreign law
relating to taxation, that (but for the measure) would be achieved by the scheme. *[Schedule 2, item 4, paragraph 177DA(2)(c)]*

3.81 The focus of this additional matter is on the result that is achieved under foreign laws relating to tax for each taxpayer that is connected with the scheme. This is relevant for determining whether a person had a purpose of enabling a taxpayer (or taxpayers) to reduce their foreign tax liability in connection with the scheme.

3.82 For example, for each member in an entity’s global group that is connected with the scheme, consideration should be given to how they are taxed in the country in which they are resident for tax purposes.

3.83 Part of this consideration will involve looking at how the income from sales to customers in Australia flows through the members of the entity’s global group and whether they are subject to tax on that income in any country. The extent to which this income is not subject to tax in any country will be relevant for determining whether the taxpayer had a purpose of reducing a foreign tax liability in connection with the scheme.

3.84 For the additional matter in paragraph 177DA(2)(c), the Commissioner need only have regard to this matter where there is sufficient information available that would allow the Commissioner to undertake this analysis. *[Schedule 2, item 4, subsection 177DA(5)]*

**Example 3.7: Operation of the principal purpose test, having regard to matter in paragraph 177DA(2)(c)**

Deamoch Inc. in Country A supplies widgets to customers in Australia under a scheme that satisfies the requirements of paragraph 177DA(1)(a).

The income from the sales of those supplies flows directly from Deamoch Inc. to Clipner Ltd. in Country B, and then again from Clipner Ltd to Clipner Holdings Inc. in Country C, where the funds are retained.

No tax is levied by Country A, B or C in respect of this income, Deamoch Inc., Clipner Ltd and Clipner Holdings Ltd are all members of the same global group.

The fact that none of the income from the sales to customers in Australia that flows through the members of the entity’s global group is subject to tax in any country may indicate a principal purpose of reducing a foreign tax liability in connection with the scheme.
Example 3.8: Operation of the principal purpose test, having regard to matters in subsection 177DA(2)

Arlow Ltd, a business based in Country A, sells online advertising services to Australian business customers. Under an agreement with the tax authority in Country A, Arlow Ltd is exempt from income tax for up to 15 years.

An Australian subsidiary of Arlow Ltd has a service contract with Arlow Ltd, which requires it to solicit Australian customers and introduce them to Arlow Ltd’s services.

Australian customers conclude contracts with Arlow Ltd and the revenue is recorded in its accounts. Once the Australian subsidiary has made contact with a customer, the customer is referred to Arlow Ltd to negotiate on the product specifications and the terms and conditions of the sale, including price. In practice, the Australian subsidiary has little involvement in these conversations and the relevant expertise does not sit in the Australian subsidiary.

Australia has a tax treaty with Country A. Under the treaty, a person acting in Australia on behalf of an enterprise of Country A, other than an independent agent, is deemed to be a permanent establishment of the Country A enterprise in Australia, if the person has, and habitually exercises in Australia, an authority to conclude contracts on behalf of the enterprise.

Having regard to the matters in subsection 177DA(2), Arlow Ltd’s arrangements do not appear to have been entered into for a principal purpose of obtaining an Australian tax benefit or reducing a foreign tax liability. Arlow Ltd’s employees undertake substantial activities that contribute to the conclusion of contracts with Australian customers. The commercial knowledge and capacity to perform those activities are all located in Country A. The service arrangement between Arlow Ltd and its Australian subsidiary accurately reflects the limited assets, risks and functions of the Australian subsidiary. While Arlow Ltd is exempt from income tax for up to 15 years, its arrangements do not appear artificial or contrived.

While the arrangements mean that the income derived from supplies to Australian customers are not attributable to an Australian permanent establishment of the foreign entity, no taxpayer connected with the scheme is considered to have a principal purpose of avoiding tax. The arrangements accurately reflect where the capacity to carry out activities relating to the consumer contracts is located. There has been no attempt to deliberately avoid creating a permanent establishment in Australia.
Example 3.9: Operation of the principal purpose test, having regard to matters in subsection 177DA(2)

Horsbell Ltd, a business based in Country B, sells enterprise software to Australian business customers.

An Australian subsidiary of Horsbell Ltd employs staff that provide significant levels of support to Australian customers. The Australian subsidiary establishes a business case for Horsbell Ltd’s products and provides customers with advice on product optimisation, pricing and terms. Australian customers who buy the product almost exclusively deal with the Australian employees.

However, the sales contracts, which are essentially negotiated by the Australian subsidiary with the Australian customer, are legally binding on Horsbell Ltd and the revenue is recorded in its accounts.

In this example, the Australian subsidiary is, through its employees in Australia, providing significant levels of support to the customer. Commercial discussions are almost exclusively conducted with the subsidiary, even though this is not permitted under its service agreement with Horsbell Ltd.

Australia has a tax treaty with Country B. The terms of that treaty are the same as for Country A (see Example 3.8, above).

Horsbell Ltd uses an identical structure throughout the region. All sales revenue from the region is recorded in Horsbell Ltd’s accounts. However, Horsbell Ltd only has a small number of employees who undertake mostly clerical work.

Horsbell Ltd pays a large license fee to a related entity (SJ1 Inc.) in a no tax jurisdiction, Country C, for the use of the intellectual property associated with the software it sells. SJ1 Inc. has no office premises. It has a post office box and there is one employee/director who attends various meetings and attends to administrative work on the registration and licensing of the patents held by SJ1 Inc.

The development of the intellectual property in relation to the patents and the decisions about its management and exploitation are undertaken by another group entity in a different jurisdiction from either Country B or Country C.

Under the tax treaty between Country B and Country C, no tax is payable in Country B on royalties paid from Country B to Country C.

However, withholding tax would have been payable in Australia if the royalty income received by SJ1 Inc. instead related to an outgoing incurred by Horsbell Ltd in carrying on business in Australia at or through a permanent establishment in Australia.
In this example, it would be concluded that Horsbell Ltd carried out the scheme for a principal purpose of enabling it and SJ1 Inc. to obtain a tax benefit.

Horsbell Ltd obtains a tax benefit by not including an amount in its assessable income from the income attributable to a permanent establishment and SJ1 Inc. obtains a tax benefit by not being liable to Australian withholding tax on the royalties it derives from Horsbell Ltd.

While the scheme might have some commercial benefits, such as centralising accounts receivable functions, which in part may have motivated the scheme, the purpose test will still be met if obtaining the tax benefit constitutes a principal purpose for the foreign entity structuring their affairs in the manner described. The matters in subsection 177DA(2) support this conclusion:

• in practice, and contrary to its services agreement with Horsbell Ltd, most of the activities that are undertaken in order to bring about the contracts for supply are undertaken by the Australian subsidiary;

• Horsbell Ltd does little to contribute to the solicitation of customers, the identification of customer needs in relation to the supply, negotiating the details of the supply to be provided and the contractual terms under which the supply will be provided, optimising the sales provided to customers in Australia, and finalising the contracts;

• Horsbell Ltd employs only a small number of staff and they do not have the necessary capability or knowledge to undertake any of the functions necessary for bringing about contracts with customers in Australia, nor do they actually undertake such functions with customers in Australia;

• the division of activities between Horsbell Ltd and the Australian subsidiary appears contrived in order to avoid creating an Australian permanent establishment;

• income from the supply to Australian customers is being returned to a no tax jurisdiction in which little real economic activity occurs; and

• royalty income paid by Horsbell Ltd to SJ1 Inc. in connection with the scheme is not subject to royalty withholding tax in Australia because Horsbell Ltd does not have an Australian permanent establishment.

As a result of the scheme, the foreign entity avoids income from the supply of software to Australian customers being attributed to a
permanent establishment in Australia. SJ1 Inc. also avoids a royalty withholding tax liability.

What will the tax outcome be where the measure applies?

3.85 Where a scheme is captured by the multinational anti-avoidance law, it will amount to a scheme to which the rest of Part IVA applies. [Schedule 2, item 4, subsection 177DA(1)]

3.86 This will trigger the Commissioner’s power under section 177F to cancel tax benefits obtained in connection with the scheme.

3.87 To identify a tax benefit obtained in connection with a scheme, and to quantify it, it is necessary to compare the tax consequences of the scheme with the tax consequences that either would have arisen, or might reasonably be expected to have arisen, if the scheme had not been entered into or carried out. This involves a comparison between the tax effects of a scheme and those of an alternative postulate.

**Step 1: Determine the scope of the alternative postulate**

3.88 The alternative postulate is a particular tax effect that ‘would have occurred’ if the scheme was annihilated, or ‘might reasonably be expected to have occurred’ had the taxpayer entered into a different arrangement that was a reasonable alternative to the actual scheme.

3.89 An alternative postulate could be merely that the scheme did not happen (the ‘would have occurred’ limb) or that the scheme did not happen but that something else did happen (the ‘might reasonably be expected to have occurred’ limb).

3.90 Although the ‘would have occurred’ limb may apply, the ‘might reasonably be expected to have occurred’ limb is likely to be more relevant to schemes captured by this measure. Working out an alternative set of facts to a scheme that included the avoidance of a permanent establishment will normally require a hypothesis that something else did occur in place of the scheme (and not just that the scheme did not happen).

3.91 A decision that a tax effect ‘might reasonably be expected to have occurred’ if the scheme had not been entered into or carried out must be based on a postulate that is a reasonable alternative to entering into or carrying out the scheme (as per subsection 177CB(3)).

3.92 Where section 177DA is triggered, a reasonable alternative to the scheme will typically include the supplies being made through an Australian permanent establishment of the foreign entity (the notional
permanent establishment). In this typical case, the notional permanent establishment could include all of the activities of the Australian-based entity that is described in subparagraph 177DA(1)(a)(iii) as well as the functions, assets and risks of the foreign entity associated with formally concluding the contracts. Another alternative may be that the notional permanent establishment includes all of the activities that are undertaken by the foreign entity, the Australian-based entity or another entity in connection with the supply.

3.93 However, the scope of a notional permanent establishment, the activities it undertakes, and its characteristics will depend on the facts and circumstances of the individual scheme. The alternative postulate is for the Commissioner to determine, however, it must meet the standard of a ‘reasonable alternative’ to the scheme being entered into or carried out (see subsection 177CB(3)).

Alternative postulate — disregard tax consequences (including foreign tax liabilities)

3.94 Subparagraph 177CB(4)(a)(ii) and paragraph 177CB(4)(b) have the effect that certain tax liabilities are not to be taken into account in assessing the likelihood or reasonableness of any alternative postulate.\(^4\)

3.95 These provisions are intended to make clear that alternative postulates should not be rejected as unreasonable postulates on the grounds that the tax costs involved in undertaking those postulates would have caused the parties to either abandon or indefinitely defer the schemes and/or the wider transactions of which they were a part.\(^5\) However, these provisions currently only apply in relation to Australian income tax consequences.

3.96 The multinational anti-avoidance law is capable of capturing schemes that have a purpose of reducing a foreign tax liability. Unlike the general anti-avoidance rule purpose test in section 177D, the purpose test under this measure can be satisfied by a purpose of both obtaining a tax benefit and reducing one or more taxpayers’ liabilities to tax under a foreign law.

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\(^4\) See paragraph 1.118 of the Explanatory Memorandum to the Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013.

\(^5\) See paragraph 1.111 of the Explanatory Memorandum to the Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013.
3.97 As a consequence, this measure extends subparagraph 177CB(4)(a)(ii) and paragraph 177CB(4)(b), for the purposes of schemes captured under the multinational anti-avoidance law, so that results in relation to the operation of any foreign law relating to taxation are also disregarded (and not just Australian income tax consequences). [Schedule 2, item 3, subsection 177CB(5)]

**Step 2: Work out the tax effects of the alternative postulate**

3.98 Once the alternative postulate is determined, the next step is to work out the tax effects of the alternative postulate.

3.99 A comparison between the tax effects of the scheme and the tax effects of the alternative postulate allows the identification of a tax benefit obtained in connection with the scheme. Under subsection 177C(1), tax benefits that may be identified include:

- an amount not being included in assessable income;
- a deduction being allowed;
- a capital loss being incurred;
- a foreign income tax offset being allowed; and
- a taxpayer not being liable to pay withholding tax on an amount.

3.100 Section 177F does not require that the tax benefit cancelled is the same tax benefit that is relevant to the purpose test. What is required is that the tax benefit has been obtained by a taxpayer in connection with the scheme. The Commissioner does not have the power to cancel a benefit obtained by a taxpayer in relation to a foreign tax law.

3.101 With respect to schemes captured by this measure, section 177F would allow the Commissioner to make a determination cancelling a tax benefit that the foreign entity obtained in connection with the scheme. It may also allow the Commissioner to make determinations cancelling any tax benefits obtained by other taxpayers in connection with the scheme.

3.102 As noted above, where a scheme is captured under this measure, the alternative postulate will typically include supplies being made to Australian customers through an Australian permanent establishment (the notional permanent establishment) of the foreign entity. Two of the tax benefits that may be cancelled under section 177F are likely to be particularly relevant to such schemes. These are:
• an amount not being included in the assessable income of a taxpayer; and

• a taxpayer not being liable to pay withholding tax on an amount.

**Tax benefit — assessable income**

3.103 Determining that an amount would have or might reasonably be expected to have been included in a taxpayer’s assessable income if a scheme captured by this measure had not been entered into or carried out will typically require the profits attributable to the notional Australian permanent establishment to be worked out.

3.104 This is because, where a foreign entity has a permanent establishment in Australia, under both Australia’s tax treaties and Subdivision 815-C of the ITAA 1997, the profits attributable to an Australian permanent establishment will usually have an impact on the calculation of an entity’s taxable income, including their assessable income, in Australia.

3.105 The approach of attributing profits to a permanent establishment in accordance with the arm’s length principle is contained in Australia’s tax treaties (see, for example, paragraph 2 of Article 7 of the United Kingdom Convention). Section 815-225 of the ITAA 1997 reflects this approach in the concept of ‘arm’s length profits’ of a permanent establishment. Additionally, section 815-225 of the ITAA 1997 applies for the purposes of Australian permanent establishments of residents of countries with which Australia does not have a tax treaty.

3.106 Once the profits attributable to the notional Australian permanent establishment have been worked out in accordance with the arm’s length principle, it is necessary to determine the impact of those attributed profits on the foreign entity’s Australian taxable income. Any elements in the calculation of the foreign entity’s taxable income under the relevant sections of the tax law must be considered (see paragraphs 4.15 and 4.16 of the Explanatory Memorandum to the Taxation Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013 and paragraphs 3.28 and 3.29 of Taxation Ruling TR 2001/11).

3.107 For example, in some circumstances, under the alternative postulate, the calculation of the foreign entity’s Australian taxable income will be limited by the profits attributable to the notional Australian permanent establishment. This would be the case where the foreign entity derives other Australian sourced income that is not attributable to the notional permanent establishment: Australia would not be permitted to tax
that income under a relevant tax treaty. In such circumstances the foreign entity’s taxable income will be limited to the amount of the profits attributable to the notional permanent establishment.

3.108 In some circumstances the foreign entity’s Australian taxable income may be less than the profits attributable to the permanent establishment such as where the income is non-assessable non-exempt income (NANE income) or exempt income. In these circumstances the entity’s taxable income will remain the (lower) amount of taxable income.

3.109 Determining the entity’s taxable income may also be impacted by special provisions in the relevant tax treaty, such as source deeming rules. Source deeming rules ensure that income that Australia is permitted to tax under the relevant tax treaty, for example, the income that forms part of the profits attributable to a permanent establishment in Australia, is deemed to have an Australian source for Australian tax purposes (see, for example, Article 21 of United Kingdom Convention). An equivalent deeming rule is contained in subsection 815-230(1) of the ITAA 1997 for the arm’s length profits of a permanent establishment in Australia.

3.110 Accordingly, an item of income derived by a foreign entity (that is not NANE income or exempt income) that would have or might reasonably be expected to have been deemed to have an Australian source, as part of the profits attributable to a notional Australian permanent establishment of the foreign entity under an alternative postulate, will form part of a tax benefit obtained in connection with the scheme. The item of income will constitute an amount that would have or might reasonably be expected to have been included in the foreign entity’s assessable income if the scheme had not been entered into or carried out.

Tax benefit — withholding tax

3.111 Part IVA allows the Commissioner to cancel withholding tax benefits obtained under or in connection with a scheme (paragraph 177C(1)(bc) and subsection 177F(2A)).

3.112 For schemes where, as part of the alternative postulate, the foreign entity might reasonably be expected to incur royalty or interest expenses with respect to the notional Australian permanent establishment, the Commissioner may determine that the recipient of the payment is subject to withholding tax under section 128B on that amount.
Example 3.10: Tax outcome – foreign entity resident in treaty country

In Example 3.9 above, the foreign entities (Horsbell Ltd and SJ1 Inc.) have obtained Australian tax benefits in connection with the scheme and meet the conditions to be subject to this measure.

For Horsbell Ltd, a reasonable alternative postulate is that the supplies were made through a permanent establishment in Australia of Horsbell Ltd. This notional permanent establishment would be a ‘dependent agent’ permanent establishment, in accordance with the tax treaty between Australia and Country B.

This is on the basis that, under the tax treaty, a person acting in Australia on behalf of an enterprise of Country B, other than an independent agent, is deemed to be a permanent establishment of the multinational entity in Australia, if the person has, and habitually exercises in Australia, an authority to conclude contracts on behalf of the enterprise.

The notional permanent establishment would include all of the activities that the dependant agent undertakes in Australia on behalf of Horsbell Ltd.

The tax benefit obtained by Horsbell Ltd under the scheme is the amount not being included in Horsbell Ltd’s assessable income which would have or might reasonably be expected to have been included if it had made the supplies to Australian customers through the notional permanent establishment.

The tax benefit would include the amount of assessable income attributable to the notional permanent establishment under arm’s length conditions (worked out in accordance with the relevant tax treaty between Australia and Country B, and Subdivision 815-C of the ITAA 1997).

In accordance with the tax treaty, and section 815-230 of the ITAA 1997, this assessable income would have an Australian source. The Commissioner would include this amount in Horsbell Ltd’s assessable income under paragraph 177F(1)(a).

To the extent that the license fee paid by Horsbell Ltd to SJ1 Inc. was incurred, in the alternative postulate, with respect to the notional permanent establishment, SJ1 Inc. has obtained a tax benefit with respect to withholding tax under paragraph 177C(1)(bc). The Commissioner may determine that these amounts are subject to withholding tax under subsection 177F(2A). The rate of the withholding tax would be as prescribed in the tax treaty between Australia and Country C (where SJ1 Inc. is resident).
Example 3.11: Tax Outcome – foreign entity resident in non-treaty country

Assume the same set of facts as for Example 3.9, above, except that Australia has no tax treaty with Country B, where Horsbell Ltd is resident.

For Horsbell Ltd, a reasonable alternative postulate is that the supplies were made through a permanent establishment in Australia of Horsbell Ltd. The notional permanent establishment would amount to a permanent establishment within the definition of permanent establishment in subsection 6(1).

The tax benefit would include the amount of assessable income attributable to the notional permanent establishment under arm’s length conditions (worked out in accordance with Subdivision 815-C of the ITAA 1997).

In accordance with section 815-230 of the ITAA 1997, this assessable income would have an Australian source. The Commissioner may include this amount in Horsbell Ltd’s assessable income under paragraph 177F(1)(a).

To the extent that the interest or royalties paid by Horsbell Ltd to SJ1 Inc. were incurred, in the alternative postulate, with respect to the notional Australian permanent establishment, SJ1 Inc. has obtained a tax benefit in respect to withholding tax under paragraph 177C(1)(bc).

The Commissioner may determine that these amounts are subject to withholding tax under subsection 177F(2A). The rate of the withholding tax would be as prescribed in the tax treaty between Australia and Country C (where SJ1 Inc. is resident). If there is no tax treaty between Australia and Country C, then the current rate of 30 per cent would apply.

Step 3: Compensating adjustments

3.113 Where the Commissioner has made a determination under subsection 177F(1) or subsection 177F(2A), cancelling a tax benefit, the Commissioner may also make a ‘compensating adjustment’ under subsection 177F(3). A compensating adjustment may be made in relation to a taxpayer, where, in the opinion of the Commissioner, it is fair and reasonable to do so.

3.114 In situations where the alternative postulate includes a notional Australian permanent establishment, in relation to which a determination to include an amount in a taxpayer’s assessable income has been made, it may also be open to the Commissioner to make a compensating adjustment, allowing deductions (paragraph 177F(3)(b)). The combination
of determinations including amounts in a taxpayer’s assessable income, and determinations allowing deductions is the mechanism by which the arm’s length profits of a notional permanent establishment in an alternative postulate could be included in a taxpayer’s assessment.

3.115 However, where the foreign entity might reasonably be expected to incur royalties or interest with respect to its notional Australian permanent establishment, the Commissioner will need to determine whether it is fair and reasonable to provide a compensatory adjustment for this expense under subparagraph 177F(3)(b)(ii), particularly where withholding tax has not been applied to that amount.

3.116 The Commissioner will also consider whether the conditions under which the amount is paid are consistent with the arm’s length principle in Subdivision 815-B of the ITAA 1997.

**Example 3.12: Tax outcome – Compensating adjustments**

The facts and conclusions are the same as Example 3.10 above. In addition, assume that the license fee paid by Horsbell Ltd to SJ1 Inc. was incurred with respect to the notional Australian permanent establishment and the Commissioner determined that SJ1 Inc. is subject to withholding tax on this amount under subsection 177F(2A). Also assume that SJ1 Inc. complies with the determination and makes full payment in respect of the tax liability.

The issue arises as to whether it is fair and reasonable for the Commissioner to provide a compensating adjustment for Horsbell Ltd in respect of the license fee expense.

In considering this issue, it is relevant that because the withholding tax aspects relating to the license fee will arise in respect to a notional permanent establishment, no withholding would have taken place by Horsbell Ltd. Under section 26-25 of the ITAA 1997 a deduction would not be allowable to a payer in determining its taxable income if it failed to withhold. However, a deduction is allowable to the payer if the withholding tax payable is paid.

Given that SJ1 Inc. has made full payment in respect of the withholding tax liability, the Commissioner would consider that it would be fair and reasonable to make a compensatory adjustment to recognise a deduction for the license fee.
Consequential amendments

3.117 There are a number of consequential amendments to the tax law to accommodate the introduction of the multinational anti-avoidance law into Part IVA. [Schedule 2, items 2, 5 and 6]

Application and transitional provisions

3.118 This measure applies on or after 1 January 2016 in connection with a scheme, whether or not the scheme was entered into, or was commenced to be carried out, before that day. [Schedule 2, item 7]

3.119 However, the measure does not apply in relation to tax benefits that a taxpayer derives before 1 January 2016. [Schedule 2, item 7]

Example 3.13: Application provision

The facts and conclusions are the same as Example 3.10 above. In addition, assume that for the income year ending 30 June 2016 for Horsbell Ltd the amount of assessable income attributable to the notional permanent establishment is $10 million, and that $6 million was derived from 1 January 2016.

Under the application provision only amounts derived, or which should have been derived on or after 1 January 2016, are considered to be a tax benefit. Accordingly, the Commissioner would only include $6 million in Horsbell Ltd’s assessable income under paragraph 177F(1)(a).

STATEMENT OF COMPATIBILITY WITH HUMAN RIGHTS

Prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011

Multinational anti-avoidance law

3.120 This Schedule is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the Human Rights (Parliamentary Scrutiny) Act 2011.
Overview

3.121 Schedule 2 to this Bill amends the anti-avoidance provisions in the ITAA 1936 to introduce the multinational anti-avoidance law.

3.122 The multinational anti-avoidance law is designed to counter the erosion of the Australian tax base by multinational entities using artificial or contrived arrangements to avoid the attribution of business profits to Australia through a taxable presence in Australia.

Human rights implications

3.123 This Schedule does not engage any of the applicable rights or freedoms as it applies to multinational entities not individuals.

Conclusion

3.124 This Schedule is compatible with human rights as it does not raise any human rights issues.
Chapter 4
Stronger penalties to combat tax avoidance and profit shifting

Outline of Chapter

4.1 The amendments in Schedule 3 double the maximum administrative penalties that can be applied by the Commissioner of Taxation to significant global entities that enter into tax avoidance or profit shifting schemes.

4.2 The increased penalties will help to deter tax avoidance.

Context of amendments

Operation of the existing law

4.3 The administrative penalties for entering into tax avoidance or profit shifting schemes are in Subdivision 284-C in Schedule 1 to the *Taxation Administration Act 1953*. All legislative references in this Chapter are to Schedule 1 to that Act unless otherwise specified.

4.4 Section 284-145 imposes an administrative penalty if an entity seeks to obtain a scheme benefit under a tax avoidance or transfer pricing scheme. The amount of the scheme benefit is generally the amount by which the entity’s tax-related liability would be reduced under the scheme if the relevant anti-avoidance or transfer pricing provision did not apply (section 284-150).

4.5 Penalties are worked out by reference to a base penalty amount for a particular breach. The base penalty amount generally reflects a portion of the underlying scheme benefit sought. To work out the penalty imposed, adjustments may be made to the base penalty amount to take into account aggravating or mitigating factors (sections 284-220 to 284-225 in Subdivision 284-D).

4.6 Division 298 sets out the machinery provisions for the assessment, collection and remission of penalties.
Summary of new law

4.7 The amendments in the Schedule 3 double the penalties imposed on significant global entities that enter into tax avoidance or profit shifting schemes. The amendments will not apply to taxpayers that adopt a tax position that is reasonably arguable.

Comparison of key features of new law and current law

<table>
<thead>
<tr>
<th>New law</th>
<th>Current law</th>
</tr>
</thead>
<tbody>
<tr>
<td>The maximum penalty applicable is generally 100 per cent of the amount of tax avoided under the scheme (but can be up to 120 per cent where aggravating factors apply). The increased penalty only applies to significant global entities. Taxpayers that adopt a tax position that is reasonably arguable will not be liable to increased penalties.</td>
<td>Administrative penalties are imposed on taxpayers that enter into tax avoidance or profit shifting schemes. The maximum penalty applicable is generally 50 per cent of the amount of tax avoided under the scheme (but can be up to 60 per cent where aggravating factors apply).</td>
</tr>
</tbody>
</table>

Detailed explanation of new law

4.8 The amount of the penalty imposed for entering into a tax avoidance or profit shifting scheme is doubled for significant global entities that do not have a reasonably arguable position. [Schedule 3, item 1, subsection 284-155(3)]

Significant global entity

4.9 The amendments apply to a significant global entity. A significant global entity is broadly an entity with an annual global income of $1 billion or more (see Chapter 2 for a more detailed explanation of significant global entities). [Schedule 3, item 1, paragraph 284-155(3)(a)]

4.10 Schedule 1 to this Bill introduces a standard and centralised set of concepts that can be used to determine whether an entity is a ‘significant global entity’.
Reasonably arguable position

4.11 The amendments do not apply to taxpayers who have a ‘reasonably arguable position’ on the application of the relevant adjustment provision. [Schedule 3, item 1, paragraph 284-155(3)(b)]

4.12 The purpose of this exclusion is to ensure that penalties are not increased where the breach is the result of uncertainty in the tax laws.

4.13 Subsection 284-15(1) sets out the test to determine whether a particular way of applying the law is reasonably arguable.

4.14 The reasonably arguable position is an objective standard involving an analysis of the law and application of the law to the relevant facts. The position must be a contentious area of law, where the relevant law is unsettled or where, although the principles of the law are settled, there is a serious question about the application of those principles to the circumstances of the particular case. Miscellaneous Taxation Ruling 2008/2 provides further information on the interpretation of this standard.

4.15 Additional documentation requirements, imposed under Subdivision 284-E, must be satisfied before a taxpayer can have a reasonably arguable position in transfer pricing matters.

Summary of penalty amounts

4.16 The following table sets out the new penalties that apply to significant global entities that enter into tax avoidance or profit-shifting schemes. Penalties are expressed as a percentage of the relevant scheme shortfall amount.
Table 4.1 Scheme penalty amounts for significant global entities

<table>
<thead>
<tr>
<th>Culpable behaviour</th>
<th>Base penalty amount</th>
<th>Aggravating factors apply</th>
<th>Disclosure during examination</th>
<th>Disclosure before examination</th>
</tr>
</thead>
</table>

* Tax avoidance schemes include profit-shifting schemes where the taxpayer has a sole or dominant purpose of obtaining a transfer pricing benefit from the scheme.

Application and transitional provisions

4.17 The amendments apply to scheme benefits that an entity gets in relation to an income year commencing on or after 1 July 2015 (regardless of when the scheme was entered into or carried out). [Schedule 3, item 2]

STATEMENT OF COMPATIBILITY WITH HUMAN RIGHTS

Prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011

Stronger penalties to combat tax avoidance and profit shifting

4.18 This Schedule is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the Human Rights (Parliamentary Scrutiny) Act 2011.
Overview

4.19 Schedule 3 to this Bill amends the *Taxation Administration Act 1953* to double the penalties imposed on significant global entities that enter into tax avoidance or profit shifting schemes. The amendments will not apply to taxpayers that adopt a tax position that is reasonably arguable.

Human rights implications

4.20 This Schedule does not engage any of the applicable rights or freedoms as it applies to multinational entities not individuals.

Conclusion

4.21 This Schedule is compatible with human rights as it does not raise any human rights issues.
Chapter 5
Country-by-Country reporting

Outline of chapter

5.1 Schedule 4 to this Bill implements Action 13 of the G20 and Organisation for Economic Co-operation and Development’s (OECD’s) Action Plan on Base Erosion and Profit Shifting (the BEPS Action Plan). Action 13 developed new standards for transfer pricing documentation and Country-by-Country (CbC) reporting. These amendments require significant global entities to provide three statements to the Commissioner of Taxation (Commissioner) with relevant and reliable information to assist the Commissioner carry out transfer pricing risk assessments.

5.2 Unless otherwise noted, all legislative references in this chapter are to the Income Tax Assessment Act 1997 (ITAA 1997).

Context of amendments

Background

5.3 Australia’s transfer pricing rules seek to ensure an appropriate return for the contribution made by the Australian operations of a multinational is taxable in Australia for the benefit of the community. These rules provide a legislative framework, based on the arm’s length principle, which ensures that an entity’s tax position is consistent with that of an independent entity dealing wholly independently with others. They align Australian domestic law with the international transfer pricing standards set out in the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations approved by the Council of the OECD and last amended on 22 July 2010 (the Transfer Pricing Guidelines).

5.4 In addition, section 284-255 of Schedule 1 to the Taxation Administration Act 1953 (TAA 1953) sets out the records that an entity may prepare and maintain in order to demonstrate that it has correctly applied the transfer pricing rules. These records should:

- be prepared before an entity lodges its tax return;
- be in English, or readily convertible to English; and
5.5 If an entity does not meet these documentation standards and the Commissioner makes a transfer pricing adjustment, the administrative penalties in Division 284 of Schedule 1 to the TAA 1953 would apply as though a transfer pricing treatment was not reasonably arguable. The entity may then be liable for a higher base penalty amount than if it had a reasonably arguable position.

5.6 The BEPS Action Plan, adopted by OECD and G20 countries in 2013, is a fifteen-point plan designed to ensure that profits are taxed where activities that generate profits are performed. Action 13 of the BEPS Action Plan recognises that enhancing transparency for tax administrations, by providing them with adequate information to conduct transfer pricing risk assessments, is an essential part of tackling profit shifting.

5.7 The OECD’s 2014 report on Action 13, Guidance on Transfer Pricing Documentation and Country-by-Country Reporting (Action 13 report) contains a new Chapter V of the Transfer Pricing Guidelines that sets out revised standards for transfer pricing documentation. It recommends that jurisdictions require multinationals to provide information through three reports: a ‘CbC report’, a ‘master file’ and a ‘local file’.

5.8 The CbC report, master file and local file together will provide a clear overview of key financial and operational metrics relevant to a global group, as well as their Australian operations. This information will provide the Australian Taxation Office (ATO) and other tax authorities with useful information to assess transfer pricing risks and, when necessary, to commence and target audit enquiries.

5.9 As outlined in the OECD’s February 2015 report, Guidance on the Implementation of Transfer Pricing Documentation and Country-by-Country Reporting, it is envisaged that, in most cases, CbC reports will be filed in the jurisdiction of the multinational group’s global parent entity and automatically exchanged with tax authorities in other jurisdictions in which the group operates. The OECD has developed three model competent authority agreements that could be used to facilitate the exchange of CbC reports. Australia envisages making CbC reports filed in Australia available for exchange under such arrangements, and receiving CbC reports from other jurisdictions.
Summary of new law

5.10 Schedule 4 inserts new Subdivision 815-E into Division 815 requiring significant global entities that are Australian residents or foreign residents with an Australian permanent establishment (PE) provide a CbC report, a master file and a local file to the Commissioner.

5.11 Failure to provide this information will not in itself prevent an entity from having a reasonably arguable position if documentation is still maintained in accordance with existing requirements.

5.12 The amendments made by this Schedule apply in relation to income years starting on or after 1 January 2016.

Comparison of key features of new law and current law

<table>
<thead>
<tr>
<th>New law</th>
<th>Current law</th>
</tr>
</thead>
<tbody>
<tr>
<td>Entities with annual global revenue of $1 billion or more must provide the following three statements to the Commissioner:</td>
<td>In order to have a reasonably arguable position in relation to a transfer pricing position, an entity must maintain specific transfer pricing documentation.</td>
</tr>
<tr>
<td>• the CbC report;</td>
<td></td>
</tr>
<tr>
<td>• a master file; and</td>
<td></td>
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<tr>
<td>• a local file.</td>
<td></td>
</tr>
<tr>
<td>Entities with annual global revenue under $1 billion do not need to provide these statements.</td>
<td></td>
</tr>
<tr>
<td>All entities must continue to maintain specific transfer pricing document to maintain a reasonably arguable transfer pricing position.</td>
<td></td>
</tr>
</tbody>
</table>

Detailed explanation of new law

What entities need to report?

5.13 Australian entities that were significant global entities in the previous income year are required to provide one or more statements to the Commissioner. These statements need to be in the approved form and provided within 12 months of the end of the income year to which the statement relates. This includes Australian resident entities and foreign
entities with a PE in Australia. [Schedule 1, item 3, section 960-555 and Schedule 4, item 1, subsections 815-355(1) and (2) of the ITAA 1997]

5.14 Entities that are consolidated for Australian income tax purposes need only report as a single entity as the reporting obligation will rest with the head company of the consolidated (or multiple entry consolidated) group. This is because the single entity rule in section 701-1 will treat a subsidiary member of a consolidated group as a part of the head company for these purposes. The obligation to report is within the core purposes listed in section 701-1 as the information contained in the report is relevant and incidental to working out the head company’s income tax liability.

**Replacement reporting periods**

5.15 The Commissioner may, by notice in writing, allow an entity to submit one or more statements in relation to a 12 month period other than an income year. This allows the Commissioner to provide entities with some flexibility in situations where an Australian subsidiary has a different income year from its parent company and may be required to submit both a local file (relating to its income year) and a CbC report (relating to its parent’s income year). [Schedule 4, item 1, subsection 815-360(1) of the ITAA 1997]

5.16 Such notification is not a legislative instrument within the meaning of section 5 of the Legislative Instruments Act 2003 because it is not legislative in character. [Schedule 4, item 1, subsection 815-360(2) of the ITAA 1997]

**Exemptions**

5.17 The Commissioner may exclude specific entities from having to provide a statement through a written notification. Such notification is not a legislative instrument within the meaning of section 5 of the Legislative Instruments Act 2003 because it is not legislative in character. [Schedule 4, item 1, subsections 815-365(1) and (2) of the ITAA 1997]

5.18 The Commissioner may also provide an exemption for a specified class of entity by legislative instrument. [Schedule 4, item 1, subsection 815-365(3) of the ITAA 1997]

5.19 The Commissioner may choose to take the following factors into account when making a decision to provide an exemption to an entity or class of entities:

- the risk profile of the local entity, including for example the amount of its overseas dealings;
5.20 For example, a local entity may only be required to provide the master file and local file to the Commissioner, in circumstances where its global parent entity has made a CbC report available to a tax authority in a jurisdiction with which Australia has an information-sharing arrangement in place, and the ATO will receive the CbC from the other tax authority. Similarly, a local entity may not need to provide the master file if another member of its multinational group that is an Australian resident has provided the master file to the Commissioner.

5.21 It is expected that the Commissioner will provide more comprehensive guidance around how this exemption power will be applied.

5.22 In addition, classes of entities may be excluded from these reporting obligations by regulation. Of note, section 909-1 provides that the Governor-General may prescribe matters that the ITAA 1997 permits to be prescribed. \([\text{Schedule 4, item 1, paragraph 815-355(1)(d) of the ITAA 1997]}\]

**What information needs to be reported?**

**A three-tiered approach to transfer pricing documentation**

5.23 An entity subject to these reporting obligations will need to provide each of the following statements to the Commissioner:

- a master file providing an overview of the multinational enterprise group business, including the nature of its global business operations, its overall transfer pricing policies, and its global allocation of income and economic activity;

- a local file focusing on specific transactions between the reporting entity and its associated enterprises in other countries, as well as the amounts involved in those transactions, and the entity’s analysis of the transfer pricing determinations that it has made; and

- a CbC report containing certain information relating to the global allocation of the multinational enterprise’s income and taxes paid together with certain indicators of the location of economic activity within the multinational enterprise group.

\([\text{Schedule 4, item 1, subsection 815-355(3) of the ITAA 1997}]}\]
5.24 The content of these three statements are further described in Annexes I to III of Chapter V of the Transfer Pricing Guidelines as set out in the Action 13 report.

5.25 There is a degree of overlap between the documentation standards in Subdivision 284-E of Schedule 1 to the TAA 1953 and the local file as described in Annex II to Chapter V of the Transfer Pricing Guidelines as set out in the Action 13 report. Both require entities to analyse and document similar matters in relation to their transfer pricing positions, including, for example:

- the circumstances, including the functions performed, assets used and risks borne by the relevant entities;
- the most appropriate transfer pricing method and the reasons for choosing that method; and
- the existence of any comparable circumstances, the degree of comparability and whether any adjustments are necessary to eliminate the effect of material differences between those circumstances.

5.26 Accordingly, entities may draw much of the content for the local file from documentation that meets the requirements in Subdivision 284-E of Schedule 1 to the TAA 1953. For example, an entity that has conducted and documented a comparability analysis for a transfer pricing treatment in accordance with Subdivision 284-E of Schedule 1 to the TAA 1953, may use that analysis without modification for the purposes of the local file.

Providing each statement in the approved form

5.27 Entities must provide each statement to the Commissioner in the ‘approved form’. The concept of approved forms is used in the tax laws to provide administrative flexibility to specify the precise form of information required and the manner of providing it. This allows the Commissioner to take into account entities’ existing reporting obligations when determining the information to be provided in the approved form. It also allows for any agreed future updates to the standards in Annexes I to III of Chapter V of the Transfer Pricing Guidelines as set out in the Action 13 report to be implemented administratively. [Schedule 4, item 1, subsection 815-355(1) of the ITAA 1997]

5.28 The information required to be provided in the approved form will take account of the guidance provided in Chapter V of the Transfer Pricing Guidelines as set out in the Action 13 report, which recognises
that there is a balance to be struck between gathering useful information and imposing a disproportionate compliance burden on taxpayers.

5.29 For example, it is envisaged that the approved forms will include materiality thresholds in relation to reportable transactions as contemplated in paragraph 32 of Chapter V of the Transfer Pricing Guidelines as set out in the Action 13 report. That guidance provides that individual countries should establish materiality standards that are objective, commonly understood and accepted in commercial practice. Factors the Commissioner may take into account when determining materiality could include:

- the size and nature of the transaction;
- whether the transaction is the subject of an existing administrative safe harbour; and
- whether the transactions are the subject of other administrative arrangements such as Advance Pricing Arrangements and Advance Compliance Arrangements.

**Lodgement dates**

5.30 Each statement is due to the Commissioner within 12 months of the end of the income year (or replacement reporting period) to which the statement relates. *(Schedule 4, item 1, subsections 815-355(2) and 815-360(1) of the ITAA 1997)*

5.31 However, section 388-55 of Schedule 1 to the TAA 1953 allows the Commissioner to defer the time that entities must lodge a statement in the approved form. This means that entities may lodge these statements by a later date where that has been approved by the Commissioner.

5.32 Alternatively, taxpayers may prefer to provide relevant statements at the same time as lodging their income tax return and the ATO is expected to facilitate this.
Penalties for non-compliance

5.33 Australia’s tax laws contain a range of penalties for entities that do not comply with their reporting obligations. For example;

- Division 284 of Schedule 1 to the TAA 1953 sets out the penalties that apply to entities that make false or misleading statements about tax-related matters; and

- Division 286 of Schedule 1 to the TAA 1953 sets out the penalties that apply to entities that fail to lodge statements on tax-related matters on time.

5.34 This means, for example:

- an entity that makes a false or misleading statement because of an intentional disregard of the tax laws may be liable to an administrative base penalty amount of 60 penalty units — per table item 3A of subsection 284-90(1) of Schedule 1 to the TAA 1953;

- an entity that makes a false or misleading statement through recklessness as to the operation of the tax laws may be liable to an administrative base penalty amount of 40 penalty units — per table item 3B of subsection 284-90(1) of Schedule 1 to the TAA 1953; or

- an entity that makes a false or misleading statement because of a failure to take reasonable care to comply with the tax laws may be liable to an administrative base penalty amount of 20 penalty units — per table item 3C of subsection 284-90(1) of Schedule 1 to the TAA 1953.

5.35 Similarly, an entity that fails to provide a statement on time, or in the approved form, may be liable under subsection 286-75(1) of Schedule 1 to the TAA 1953 to an administrative base penalty amount of five penalty units for each period of up to 28 days from when the document was due to a maximum of five periods (see section 286-80 of Schedule 1 to the TAA 1953).

5.36 The Commissioner has the discretion to remit an administrative penalty in whole or in part under section 298-20 of Schedule 1 to the TAA 1953.
5.37 An entity will not be eligible to have a reasonably arguable position in relation to a transfer pricing matter by reason of providing the three statements described at paragraph 5.23 to the Commissioner. However, regardless of whether an entity fails to provide a statement on time, or in the approved form, it would still be eligible to have a reasonably arguable position in relation to a transfer pricing matter if it meets the documentation requirements in section 284-255 of Schedule 1 to the TAA 1953.

Consequential amendments

5.38 These amendments insert guidance material for Subdivision 815-E. [Schedule 4, item 1, section 815-350 of the ITAA 1997]

Application and transitional provisions

5.39 These amendments apply in relation to income years commencing on or after 1 January 2016. [Schedule 4, item 2]

Statement of Compatibility with Human Rights

Prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011

Country-by-country reporting

5.40 This Schedule is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the Human Rights (Parliamentary Scrutiny) Act 2011.

Overview

5.41 This Schedule amends the ITAA 1997 to require significant global entities to file one or more statements with the Commissioner. These statements will provide the Commissioner with relevant and reliable information to carry out transfer pricing risk assessments.
**Human rights implications**

5.42 This Schedule does not engage any of the applicable rights or freedoms, as it applies to multinational entities not individuals.

**Conclusion**

5.43 This Schedule is compatible with human rights as it does not raise any human rights issues.
Chapter 6
Regulation impact statement

BACKGROUND

Global action to address base erosion and profit shifting

6.1 Globalisation has exacerbated opportunities for corporate tax avoidance. Internationally, this is known as base erosion and profit shifting (BEPS). Profit shifting is the practice of moving profit from a higher tax country in which economic activity is happening to a lower tax country in order to minimise tax. Profit shifting can lead to governments collecting less revenue - also known as tax base erosion.

6.2 The global reach of multinational enterprises, the increasing importance to production of intangible capital (such as intellectual property, goodwill or 'brand names'), rapid developments in information and communication technology and the integration of production in global value chains have increased opportunities for BEPS.

6.3 In response, the G20 mandated the Secretary-General of the Organisation for Economic Co-operation and Development (OECD) to develop an action plan aimed at addressing BEPS. The G20/OECD action plan aims to address the weaknesses in the current international tax rules that allow some companies paying little or no tax. The action plan includes 15 action items in three policy areas.

• Coherence: International coherence is necessary to eradicate double non-taxation. For example, actions in this area include work to address international mismatches in entity and instrument characterisation.

• Substance: Tax rules must be modified to align tax with economic substance. For example, actions in this area include work looking at how transfer pricing rules could better deal with the shifting of risks and intangibles.

• Transparency: Greater transparency can reduce the incentive to engage in aggressive tax planning and assist tax authorities to identify risk areas and focus audit strategies.
6.4 Australia, as both a G20 and OECD member country, is working with other countries to finalise this work by the end of 2015.

6.5 At the St Petersburg G20 Leaders meeting, member countries were also directed to examine how domestic laws contributed to BEPS and ensure that international and domestic tax rules do allow or encourage profit shifting.

6.6 Consistent with this direction, this regulation impact statement examines how the Australian tax system could be amended to reduce the opportunities and incentives for multinational tax avoidance. Importantly, the options examined in this regulation impact statement are consistent with the G20/OECD action plan so as not to pre-empt, duplicate or undermine that process.

6.7 An early assessment regulation impact statement for these options was considered by the Government as part of the 2015 Budget process. This standard-form regulation impact statement has been prepared for the Government’s consideration of the detail of the final legislation.

Problem

Effects of multinational tax avoidance

6.8 Tax minimisation, tax avoidance and tax evasion can be considered along a spectrum of activity. At the most egregious end, tax evasion refers to taxpayers deliberately and dishonestly breaking the law to avoid paying tax.

6.9 Next to tax evasion is a large grey area, in which taxpayers construct contrived schemes or exploit loopholes to reduce their tax liability. This is known as tax avoidance. Some tax avoidance activity might technically comply with the law but be contrary to its spirit and purpose. Other tax avoidance activity may in fact cross the line of what is legal but will require detailed investigation (and possibly litigation) to determine this.

6.10 Tax avoidance can be particularly harmful because it is far more difficult for tax administrations to take action against (compared to tax evasion). This is because, by definition, such behaviour occupies a legal grey area. As a result, it is often seen by the public as going unpunished.
6.11 If ordinary taxpayers lose confidence in the system because they see tax avoidance going unaddressed, there is likely to be a reduction in voluntary compliance. Under the Australian tax system, taxpayers are required to self-assess their tax obligations, rather than the Australian Taxation Office (ATO) reviewing every transaction or event that may have tax consequences. Voluntary compliance is the cornerstone of this system and is more readily achieved when taxpayers have confidence that the tax system is fair and is being evenly applied.

6.12 Further, if multinationals are artificially reducing their tax bills, governments are also likely to collect less revenue. The OECD has concluded that a significant source of tax base erosion globally is profit shifting.6 As a result, taxpayers not engaging in profit shifting shoulder a greater share of the tax burden (than they otherwise would) and face a competitive disadvantage.

**Extent of multinational tax avoidance**

6.13 It is difficult to accurately estimate the extent of multinational tax avoidance in Australia.

6.14 In its 2013 report, *Addressing Base Erosion and Profit Shifting*, the OECD noted the lack of available data on the extent of multinational tax avoidance and examined some of the methodological difficulties in quantifying how much BEPS actually occurs. As a result, action 11 of the G20/OECD BEPS action plan is developing recommendations regarding indicators of the scale and economic impact of BEPS and ensuring that tools are available to monitor and evaluate the effectiveness and economic impact of the actions taken to address BEPS on an ongoing basis.

6.15 Treasury also noted difficulties in assessing the level of erosion of the corporate tax base that is attributable to tax avoidance in its 2013 scoping paper, *Risks to the Sustainability of Australia’s Corporate Tax Base*.

6.16 Despite this, the scoping paper found that:

*There are real and identifiable risks facing Australia’s corporate tax base and the corporate tax bases of other countries. The increasing use of strategies to exploit gaps and inconsistencies in tax treaties, the increased ‘digitisation’ of the economy and the challenges for the international community to effectively curb the harmful tax practices*

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of some jurisdictions, have all highlighted shortcomings in the international tax framework.  

6.17 The scoping paper also observed that Australia is more vulnerable to the effects of corporate tax base erosion than other countries, given our greater reliance on corporate tax.

6.18 Despite the lack of data on the extent of multinational tax avoidance, it is likely that such behaviour has increased over time. This is primarily due to the impact of information communication and technology.

6.19 Technology has significantly decreased the cost of organising and coordinating complex activities over long distances. As a result, businesses are increasingly able to manage centrally while spreading functions and assets among multiple different countries.

6.20 This allows multinationals to allocate their functions, assets and risks across countries in a way that minimises taxation – for example, by allocating highly profitable assets to low tax countries and low value functions to high tax countries. This, in itself, is not tax avoidance; however, such a structure also allows multinationals to contractually allocate their functions, assets and risks in a way that does not fully reflect reality in order to further reduce their tax. For example, a multinational may overvalue the price paid for services by group members in high tax countries to a group member in a low tax country. This is tax avoidance.

6.21 Developments in technology have also meant that intangible assets (such as intellectual property) are becoming increasingly important to the value of countries. For example, much of the value of digital companies lies not in their tangible assets (factories, warehouses, machinery and so on) but in their software. Unlike tangible assets, intangible assets like intellectual property are easily moved between countries. Its mobility and the fact that it can be very difficult to value means that intellectual property can be used to funnel profit across the globe, from high tax to low tax countries, exploiting loopholes in the international tax system along the way.

6.22 In this way, technology has given rise to more tax avoidance opportunities than existed in the past.

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7 Treasury, Risks to the Sustainability of Australia’s Corporate Tax Base (July 2013) page 45.
Existing mechanisms to address multinational tax avoidance

6.23 Australia has robust and sophisticated laws that deal with tax avoidance by multinational companies. This includes:

- a comprehensive thin capitalisation regime which aims to prevent excessive debt deductions by companies;
- tough transfer pricing legislation to ensure cross-border related party payments are priced appropriately;
- controlled foreign company rules to prevent Australian companies shifting income offshore; and
- a general anti avoidance rule (GAAR) in Part IVA of the *Income Tax Assessment Act 1936* to capture arrangements designed to avoid paying Australian tax.

6.24 The G20/OECD action plan is also likely to result in the adoption of rules that make profit shifting more difficult. However, neither Australia’s existing laws nor the G20/OECD action plan ‘cover the field’.

6.25 For example, there are weaknesses in the application of Australia’s current GAAR to international tax avoidance schemes. Australia’s GAAR, introduced in 1981, has not kept pace with multinationals and the globalisation of their activities. Currently, the GAAR only applies to schemes that have the sole and dominant purpose of avoiding Australian tax. However, typically Australia is a relatively small element in global business structures created in order to enjoy a worldwide tax benefit. Therefore the argument can be used that a scheme is for the purpose of avoiding taxes in other countries and not Australia, which means Part IVA is ineffective in scope.

6.26 In relation to the OECD work, its effectiveness will largely depend on how widely the OECD’s recommendations are adopted. While the G20/OECD action plan will be delivered in 2015, the extent to which it is taken up will remain unclear for some time after that. It is likely that some jurisdictions will not implement all the recommendations.
6.27 In these circumstances, there is a risk that confidence in the fairness of the tax system and voluntary compliance will suffer if action is not taken in a timely way. The Senate Economic References Committee’s interim report on corporate tax avoidance, *You cannot tax what you cannot see* (18 August 2015) noted that ‘there may be value in Australia proactively continuing to identify potential risks to the integrity of the corporate tax system and take assertive actions to address these risks’.\(^8\) The Committee also considers that ‘international collaboration should not prevent the Australian Government from taking unilateral action’.\(^9\)

6.28 In this context, there is scope for Australia to take action to address identified issues ahead of the G20/OECD, as long as any measures taken are not inconsistent with the work being done by the G20/OECD. The consistency of each of the options with the OECD process is discussed further below.

6.29 The options have been designed in close consultation with Australian officials directly involved in the G20/OECD BEPS action plan so as to mitigate the risks of inconsistency.

**Objective of government action**

6.30 The objective of government action is to reduce the scope for multinational tax avoidance in Australia in a way that is consistent with the G20/OECD action plan.

**Options that may achieve objective**

6.31 The objective could be achieved in a number of ways. Options that could be inconsistent with the G20/OECD action plan have not been considered. These options could be adopted in isolation or together as a package.

**Option 1**: Status quo

**Option 2**: A Multinational Anti-Avoidance Law

**Option 3**: Country-by-Country reporting

**Option 4**: Increased penalties

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\(^8\) Page 49

\(^9\) Page 48
6.32 Options 2, 3 and 4 would only apply to multinationals with an annual global revenue of $1 billion or more (‘the revenue threshold’). This is because large multinational companies have the greatest opportunities to avoid tax through offshore activities and represent the highest risk to Australia’s tax base. This is consistent with the Government’s commitment to deregulation and small business, and with the recommended approach of the OECD on Country-by-Country reporting.

**Option 1: Status quo**

6.33 This option would involve not taking any action at the present time. Further consideration would be given to this issue when the G20/OECD action plan is finalised in late 2015. Specifically, the Government would consult on and consider whether to implement the outcomes of the G20/OECD process.

**Option 2: A Multinational Anti-Avoidance Law**

6.34 Under Australia’s bilateral tax treaties, Australia can generally tax business profits made by large foreign multinationals that carry on a business through a permanent establishment in Australia.

6.35 The permanent establishment definition can differ in each of Australia’s bilateral tax treaties. The definition typically includes a fixed place of business through which the business of an enterprise is carried on, but does not include activities which are only preparatory and auxiliary in nature. Generally, a permanent establishment will also be created if the foreign multinational has a dependent agent in Australia that habitually exercises authority to conclude contracts on behalf of the foreign multinational.

6.36 Some large foreign multinationals artificially structure their tax affairs in such a way to ensure that they are not treated as trading through a permanent establishment in Australia and as a result avoid paying the appropriate amount of Australian tax.

6.37 This proposal would introduce a new law to allow the Commissioner of Taxation to ignore, for the purposes of determining taxable Australian income, artificial or contrived structures used by multinationals to avoid having a taxable presence in Australia.

6.38 The new law would have the effect of clarifying that a limited and clearly egregious set of circumstances involving the provision of goods and services to Australians by offshore entities are considered to be tax avoidance.
6.39 The new law would address the weakness with the application of the GAAR to international tax avoidance schemes identified in paragraph 25, by:

- catching arrangements that are designed to obtain both Australian and foreign tax benefits; and

- lowering the purpose test from ‘sole or dominant purpose’ to ‘one of the principal purposes’, making it easier to apply.

6.40 The changes would apply tax benefits derived on or after 1 January 2016 to allow multinationals a transitional period to reorganise their arrangements.

6.41 The action 7 of the OECD action plan will make recommendations about strengthening the permanent establishment rules in the OECD Model Tax Convention so it is harder for taxpayers to artificially avoid permanent establishment status. The new law would be consistent with this work because it would operate as a general safeguard. The law would only apply to a multinational where there was a principal purpose of avoiding tax and this was done by avoiding a permanent establishment (as defined from time to time). In this way, the new law will ensure that both current and future rules about permanent establishments work as they were intended to.

Example 6.1

A foreign company (FCo) acquires business software from third parties which it sells to customers in Australia.

An Australian company (AusCo), which is a subsidiary of FCo, provides sales support services to FCo.

AusCo identifies new customers in Australia, and undertakes all selling activities to the point of concluding the contract with the customer. However, the contract is concluded with FCo and the purchase price paid to FCo directly.

Except for acquiring the software, concluding sales contracts and sending the software to Australian consumers, no activity is performed by FCo in relation to the Australia market.

FCo is resident in a low tax jurisdiction, and its country of residence has a tax treaty with Australia.

From an examination of the facts and circumstances around the arrangements in relation to customer contracts, it is found that there is a contrived separation of the conclusion of contracts from the selling activity and process of agreeing terms and conditions. The requirement
for FCo to conclude the contracts is deliberately intended to limit the
activity which is taxable in Australia.

The effect of this option would be to allow the Commissioner of
Taxation to calculate FCo’s taxable Australian income as if it were
selling software through a permanent establishment in Australia.

**Option 3: Country-by-Country reporting**

6.42 This option would involve implementing the OECD’s Country
by-Country reporting regime. Country-by-Country reporting is a key part
of the G20/OECD BEPS action plan and was one of the action item
delivered in 2014.

6.43 Country-by-Country reporting will provide tax authorities with a
global picture of how multinationals operate, including information on the
global allocation of profits, revenues, taxes paid and other economic
activity. The information reported by multinationals in the Country-by-
Country report will allow greater scrutiny of cross-border arrangements
by tax authorities.

6.44 Under this option, Australian headquartered multinational
companies (those who have Australian ultimate holding companies) with
a global turnover of greater than $1 billion would provide the ATO with
Country-by-Country reports annually, with the first relating to income
years commencing on or after 1 January 2016.

6.45 The Country-by-Country report requires aggregate tax
information relating to the global allocation of the income, the taxes paid,
and certain indicators of the location of economic activity among tax
jurisdictions in which the multinational group operates. The report also
requires a listing of all the constituent entities for which financial
information is reported, including the tax jurisdiction of incorporation,
where different from the tax jurisdiction of residence, as well as the nature
of the main business activities carried out by that constituent entity.

6.46 The ATO will obtain the Country-by-Country reports of foreign
multinationals operating in Australia under exchange of information
arrangements with other tax authorities. In the event that the ATO is
unable to obtain this information from other tax authorities, it will be able
to require Country-by-Country reports directly from the Australian
subsidiaries of foreign multinationals.
6.47 The OECD has also devised two other types of transfer pricing documentation standards to complement the Country-by-Country report—the local file and the master file. The master file contains an overview of the operations of the entire corporate group (in order to place the multinational group’s transfer pricing practices in their global economic, legal, financial and tax context). The local file contains information related specifically to the transactions of the local entity.

6.48 Option 3 would involve implementing these standards in addition to the Country-by-Country reports. All multinationals operating in Australia that meet the revenue threshold would be required to file these reports with the ATO.

6.49 The affected taxpayers currently prepare some, but not all, of the documentation described above under existing rules. Since 1998, the ATO has recommended Australian taxpayers maintain transfer pricing documentation to ensure they can benefit from the ‘reasonably arguable position’ defence in relation to their transfer pricing positions. This has meant that many multinationals, particularly those headquartered in Australia, already produce some of the proposed local file content, although this information is not reported to the ATO as a matter of course.

**Option 4: Increased penalties**

6.50 This option would involve increasing the administrative penalties for tax avoidance faced by multinationals. This would achieve a better balance between the financial consequences of tax avoidance and the potential gains for large companies—increasing the deterrent effect of penalties for these firms.

6.51 The focus would be administrative penalties for tax avoidance and related behaviour, specifically the penalties in Schedule 1 of the Tax Administration Act 1953 relating to tax avoidance and profit shifting schemes.

6.52 Doubling the penalties faced by multinationals would result in a maximum penalty of 120 per cent for tax (where the taxpayer has hindered the ATO or in some repeat cases). This option would not change the underlying tax obligations, only the level of the penalty that may be applied.

6.53 In recognition that the tax law does not always provide certain tax outcomes, this option would not further penalise taxpayers who have a reasonably arguable position under the tax law, as defined under Schedule 1 of the Taxation Administration Act 1953 (the Taxation Administration Act).
6.54 The Commissioner of Taxation has broad discretion to remit an administrative penalty in whole or in part so the penalties are not often imposed at the rate provided for in the Taxation Administration Act. This discretion would remain.

6.55 The new penalties would apply to tax benefits obtained on or after 1 July 2015.

6.56 None of the 15 G20/OECD BEPS actions will specifically address penalties for tax avoidance so there is no risk of inconsistency. That is, increasing penalties is complementary to the G20/OECD BEPS action plan.

Impact analysis

Option 1: Status quo

6.57 The option would have no impact on business, government or the community, with the existing tax framework continuing unchanged.

6.58 The existing settings in each area – penalties, anti-avoidance and transfer pricing documentation – as described above would continue.

Option 2: A Multinational Anti-Avoidance Law

6.59 This option would ensure that the anti-avoidance provisions are able to be applied in the specified circumstances – where multinational groups have used artificial or contrived arrangements to circumvent the international tax rules to avoid a taxable presence in Australia. This will make Australia’s tax system less vulnerable to multinational tax avoidance, increasing confidence in the integrity of the system.

6.60 For multinationals who engage in the behaviour described, this option would potentially increase their tax liability and may have a negative impact on their reputation if the determination is made public (for example, if it is contested in a court). This result is appropriate given the tax avoidance purpose of their actions.
Example 6.2

The facts are the same as example 1, with FCO selling software to customers in Australia, heavily supported by AusCo.

Before the application of the law, AusCo was only paid by FCO a service fee, based on AusCo’s costs.

Under the new law, if they are taxed like an Australian permanent establishment, they would be expected to share in the profits of the business. This means that their profit will increase as sales increase.

There may also be withholding taxes payable on interest or royalty expenses associated with the Australian sales.

6.61 The revenue that these large multinationals are earning in Australia is expected to be in the billions of dollars. However, it is extremely difficult to quantify the amount of profit that would become taxable in Australia (either as a result of ATO enforcement or behaviour change) and the subsequent tax revenue that would be raised.

6.62 As such, the gain to revenue associated with this option is unquantifiable.

6.63 There is likely to be an upfront regulatory cost associated with learning about the changes and assessing the risk of existing structures. Taxpayers with structures at risk of falling within the scope of the new law may seek advice on its potential application and, if at risk of being caught, may reassess the tax consequences of their existing structure or restructure their operations to remove the artificiality. The ongoing impact on multinational’s evaluation and planning is likely to be low.

6.64 The potential compliance burden outlined above would be limited to companies that:

- meet the global revenue threshold;
- are supplying goods or services to Australian customers but booking that revenue offshore; and
- have a principal purpose of avoiding tax.

6.65 This proposal should not have a direct impact on Australian-owned multinational companies or purely domestic Australian entities because they already have a taxable presence in Australia. These entities will continue to be subject to the GAAR.
6.66 While the new law will result in upfront compliance costs, the number of expected multinationals is expected to be limited. It is targeted at 30 large multinational companies, though up to 100 companies may need to review their arrangements to make sure they comply with the new law.

6.67 This option is expected to deliver revenue gains, as well as system wide benefits derived from improved taxpayer confidence. While these benefits are unquantifiable, they are expected to exceed the compliance costs associated with the option. As a result, the net impact is expected to be positive.

Option 3: Country-by-Country reporting

6.68 This option would provide the ATO with a global picture of how multinationals operate, allowing the ATO to better assess transfer pricing risks and allocate audit resources more efficiently.

6.69 Australian multinationals already report to the ATO certain elements of the information required in Country-by-Country, master file and local reports. However, this information only relates to the Australian operations of the multinational, and so the ATO's line of sight is restricted to one-side of any given transaction or arrangement. The proposed reporting will provide a clear overview of key financial and operational metrics relevant to the global group. A greater understanding of the economically significant elements of a multinational's entire global value chain will assist the ATO's transfer pricing examinations and the identification of profit shifting activities.

6.70 More effective administrative scrutiny may prompt multinational companies to take less aggressive tax positions.

6.71 This option would result in an unquantifiable gain to revenue as a result of behavioural change and more effective enforcement.

6.72 Australia's support for the OECD's Country-by-Country reporting initiative will encourage other countries to adopt the new reporting requirements maximising the benefits of a more transparent international tax system. The benefits of this option will be reduced if key countries do not participant as foreign multinational's Country-by-Country reports will be difficult to obtain. However, the ATO will still have the benefit of the master file and local file which are required to be lodged directly with it by all large multinationals operating in Australia.
6.73 To date, Spain, the United Kingdom, Germany and Poland have formally announced their intention to legislate the Country-by-Country reporting regime. Many other jurisdictions have indicated that they are likely to be able to implement it through administrative procedures and so have not made formal announcements.

6.74 This option would have a regulatory impact on business. Compiling and reporting the information required will require upfront system changes and ongoing resources. However, this would be limited to a small number of multinational groups. For example, the revenue threshold of $1 billion will exclude 85 to 90 percent of multinationals operating in Australia from the requirement to file a Country-by-Country, local file and master file reports.

6.75 This option is expected to deliver revenue gains, as a result of behaviour changes (multinationals taking less aggressive tax positions) and more effective enforcement, as well as system wide benefits derived from improved taxpayer confidence. While these benefits are unquantifiable, they are expected to exceed the compliance costs associated with the option. As a result, the net impact is expected to be positive.

**Option 4: Increasing penalties**

6.76 Substantially increasing the penalties for large companies will ensure a better balance between the financial consequences of tax avoidance and the potential gains for multinational companies.

6.77 Tax avoidance by these entities is arguably more serious than that engaged in by smaller entities because multinational companies have:

- more resources to devote to tax compliance activities;
- greater opportunities to avoid tax through offshore activities; and
- larger potential gains to be made by avoiding tax.

6.78 Given the consequences of non-compliance would be higher under this option, some multinationals may take conservative tax positions. For example, currently if a multinational misprices its intergroup payments in order to reduce the tax it pays in Australia, it would only face a penalty of 25 percent of the tax avoided. Under this option, the penalty would be raised to 50 percent – making this type of tax avoidance more risky for multinationals.
6.79 This option would result in net positive benefits for Government and the community. An increase in the penalties for large companies may also increase community confidence in the tax system, countering the perception that small and medium enterprises shoulder an unfair burden.

6.80 This option would have an unquantifiable gain to revenue. This is likely to result from both increased penalties being collected and an increase in primary tax compliance.

6.81 It should be noted, however, that the Commissioner does not always impose the maximum penalty (as noted at paragraph 19).

6.82 There would be no direct regulatory costs for business as the primary tax obligations would not change. As such, the net impact of the option will be positive.

Regulatory costing analysis

Option 1: Status quo

6.83 As this option does not involve changes to the status quo, no regulatory costing is required.
Option 2: Multinational Anti-Avoidance Law

<table>
<thead>
<tr>
<th>Change in costs ($million)</th>
<th>Business</th>
<th>Community Organisations</th>
<th>Individuals</th>
<th>Total change in cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total by Sector</td>
<td>$9.2 million</td>
<td>$0</td>
<td>$0</td>
<td>$9.2 million</td>
</tr>
</tbody>
</table>

The increased regulatory costs are offset by the regulatory cost reductions associated with a proposal to align the legal frameworks for personal and corporate insolvency practitioners.

<table>
<thead>
<tr>
<th>Cost offset ($million)</th>
<th>Business</th>
<th>Community Organisations</th>
<th>Individuals</th>
<th>Total by Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agency</td>
<td>$29.5 million</td>
<td>$0</td>
<td>$0</td>
<td>$29.5 million</td>
</tr>
</tbody>
</table>

Are all new costs offset?

- yes, costs are offset
- ☐ no, costs are not offset
- ☐ deregulatory, no offsets required

Total (Change in costs - Cost offset) ($million) - $20.3 million

<table>
<thead>
<tr>
<th>Potential overall costs per client ($)</th>
<th>Implementation</th>
<th>Ongoing</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$920,000</td>
<td>$0</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Potential overall market impact ($)</th>
<th>Implementation</th>
<th>Ongoing</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$92,000,000</td>
<td>$0</td>
</tr>
</tbody>
</table>

6.84 Up to 100 multinationals may be affected.

6.85 Tables 1 and 2 above summarise the potential compliance costs. It assumes that 30 affected taxpayers will need to restructure their Australian business operations to comply with the new law.

6.86 Table 1 summarises the average annual compliance costs over ten years for the total affected population.
6.87 Table 2 summarises the yearly compliance costs per multinational and for the total affected population.

6.88 All affected multinationals are likely to seek legal advice on whether the new law has an impact on their existing structure.

6.89 Multinationals who have a high risk of being caught by the new law are likely to incur both internal and external costs:

- developing and assessing the costs and benefits of alternative options for restructuring;
- documenting the preferred restructure option, its tax consequences and settling this with the ATO; and
- implementing a new business model according to the preferred restructure option.

6.90 As the law targets particular structures (rather than transactions) the ongoing costs are likely to be marginal once a compliance structure is in place.

6.91 While some taxpayers may come within the scope of the law over time as their revenue increases, most of these are likely to have already restructured as a result of the OECD’s recommended changes on permanent establishment, which are to be implemented over the next few years. The law will also deter multinationals from entering into the targeted structures in the first place.
Option 3: Country-by-Country reporting

Table 3: Average Annual Regulatory Costs (from Business as usual) for Option 3

<table>
<thead>
<tr>
<th>Change in costs ($million)</th>
<th>Business</th>
<th>Community Organisations</th>
<th>Individuals</th>
<th>Total change in cost</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total by Sector</strong></td>
<td>$14.05 million</td>
<td>$0</td>
<td>$0</td>
<td>$14.05 million</td>
</tr>
</tbody>
</table>

The increased regulatory costs are offset by the regulatory cost reductions associated with a proposal to align the legal frameworks for personal and corporate insolvency practitioners.

<table>
<thead>
<tr>
<th>Cost offset ($million)</th>
<th>Business</th>
<th>Community Organisations</th>
<th>Individuals</th>
<th>Total by Source</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Agency</strong></td>
<td>$29.15 million</td>
<td>$0</td>
<td>$0</td>
<td>$29.15 million</td>
</tr>
</tbody>
</table>

Are all new costs offset?

☑ yes, costs are offset  ☐ no, costs are not offset  ☐ deregulatory, no offsets required

| Total (Change in costs - Cost offset) ($million) | - $15.10 million |

Table 4: Summary - potential compliance costs for Option 3

<table>
<thead>
<tr>
<th>Implementation</th>
<th>Ongoing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Potential overall costs per client ($)</td>
<td>$56,028</td>
</tr>
<tr>
<td>Potential overall market impact ($)</td>
<td>$67,234,167</td>
</tr>
</tbody>
</table>

6.92 Tables 3 and 4 above summarise the potential compliance costs. They assume that:

- each Australian taxpayer that meets the revenue threshold would be required to lodge a master file and local file 12-months after year end; and
• in most cases only Australian-headquartered taxpayers above the threshold will have to lodge a Country-by-Country report.

6.93 Based on this between 800 and 1,200 multinationals will be affected, including 30 to 50 Australian-headquartered taxpayers. This population is based on the number of companies which lodge an international dealings schedule with total effective business income greater than $1 billion.

6.94 As the threshold is not indexed, there may be an increase in the affected population over time. The option has been costed using the upper estimate of the population (1,200) in part to deal with this.

6.95 Table 3 summarises the average annual compliance costs over ten years for the total affected population.

6.96 Table 4 summarises the implementation and ongoing annual compliance costs per multinational and for the total affected population.

6.97 The assessment assumes that the affected taxpayers are quite sophisticated and that the majority of information required to be completed in the forms will be relatively simple to extract once appropriate systems are in place.

Option 4: Increasing penalties

6.98 As this option does not involve changes to underlying tax obligations (only the penalties that may apply), no regulatory costing is required.

Consultation

6.99 Treasury released an issues paper in May 2013 which outlined the challenges that changes in the global economy pose to the international tax system and sought stakeholder views on whether the analysis in the paper adequately captured the key issues. The paper did not canvas potential solutions – its focus was defining the nature of the problem.

6.100 Prior to the release of the 2015 Budget, each of the options was the subject of targeted consultation with a small selection of representatives from the tax profession, business and academia. These stakeholders were given summaries of the proposals on an in-confidence basis. Treasury met with these stakeholders in groups and had one-on-one conversations, which informed the policy decision.
6.101 The limited consultation on the proposals prior to their announcement in the budget reflects the cabinet-in-confidence nature of the decision-making process.

6.102 Following the announcement of these measures in the 2015 Budget, Treasury publicly consulted on the measures as set out below.

**Multinational anti-avoidance law**

6.103 An exposure draft Bill and explanatory memorandum on the multinational anti-avoidance law were published for consultation on Budget night. The consultation period ran for four weeks and closed on 9 June.

6.104 The purpose of the consultation process was obtain feedback on the design of the law, specifically whether the law would:

- have the intended effect of enabling the ATO to take action against multinationals that artificially avoid having a taxable presence in Australia;

- have any unintended effects, including whether it would catch any legitimate business arrangements; and

- be sufficiently clear.

6.105 Treasury received 20 submissions from a range of stakeholders including: not-for-profits, professional firms and industry bodies.

6.106 Most submissions raised similar issues. The key themes included:

- a preference for waiting until the OECD/BEPS process is concluded;

- concerns about the start date and suggestions for ways in which the ATO can facilitate the transition; and

- the importance of defining key terms: ‘low or no tax’, ‘commercially dependant’, ‘substantial economic activity’ etc.

6.107 Treasury also consulted heavily with the ATO to identify any implementation issues, integrity concerns and unintended consequences.
6.108 A number of changes were made as a result of the submissions and ATO feedback. These and the names of those that made non-confidential submission are outlined in the appendix.

Country-by-Country reporting

6.109 An exposure draft Bill and explanatory memorandum to implement Country-by-Country reporting was published for consultation on 6 August. The consultation period ran for four weeks and closed on 2 September.

6.110 The purpose of the consultation process was to obtain feedback on the design of the law, specifically whether the law would have the intended effect of enabling the ATO to implement the OECD standards with sufficient flexibility.

6.111 Treasury received 15 submissions from a range of stakeholders including: not-for-profits, professional firms and industry bodies.

- Most submissions acknowledged that it was appropriate to give the ATO power to detail the content of the reports so that they could be kept up to date with any revised OECD guidance.

- Similarly, many supported the ATO’s broad powers to exempt entities from the requirement to lodge one or more of the reports; however, some expressed a preference for some exemptions to be legislated.

6.112 A number of changes were made as a result of the consultations. These and the names of those that made non-confidential submission are outlined in the appendix.

6.113 The OECD’s Country-by-Country reporting regime has also been subject to broader consultations conducted by the OECD. The OECD has been consulting publicly on revisions to its transfer pricing documentation since 2013. A number of Australian stakeholders participated in these consultations directly (including CPA Australia, Institute of Chartered Accountants in Australia, Antony Ting and Rio Tinto) or indirectly through the Business and Industry Advisory Council (BIAC) to the OECD.
Increasing penalties

6.114 An exposure draft Bill and explanatory memorandum to implement increased penalties for tax avoidance and transfer pricing schemes was published for consultation on 6 August. The consultation period ran for four weeks and closed on 2 September.

6.115 Given the simple nature of the change, the purpose of the consultation was to ensure there were no technical errors in the law.

6.116 Treasury received three submissions (from Deloitte, the Tax Justice Network and Publish What You Pay Australia, and one confidential). There were a few technical issues identified with the operation of the provisions which have been addressed. There were also policy concerns about:

• the application of the increased penalties to schemes entered into before 1 July 2015;

• the increased importance of having a reasonably arguable position and the impact of the existing documentation requirements on this; and

• the fact that the increased penalties will only apply to entities who meet the global revenue threshold of $1 billion or more.

Conclusion

6.117 The preferred option is to implement options 2, 3 and 4 as a package. Each of these options is expected to have a net benefit (although the benefits are difficult to quantify for options 2 and 3). As such, implementing options 2, 3 and 4 as a package is expected to result in the highest net benefit.

6.118 The options are complementary and address the problem of multinational tax avoidance from different angles. Country-by-Country reporting gives the ATO information to assist it target its compliance activities; increased penalties provides multinationals with a bigger incentive to comply with the law; and the multinational anti-avoidance law ensures the ATO can recover tax and penalties where a multinational has structured to avoid a taxable Australian presence.
Implementation and review

6.119  Legislation is required to implement the package. As the start dates for both Country-by-Country reporting and the multinational anti-avoidance law are 1 January 2016, a Bill implementing the package will need to be introduced to the Parliament in the spring sittings and enacted before the end of the year.

6.120  The ATO administers the existing general anti-avoidance rule, penalty regime and transfer pricing documentation rules. It is well placed to both implement the changes and monitor their effects on the behaviour of corporate taxpayers.

Multinational Anti-Avoidance Law

6.121  The ATO’s existing policies and procedures for the administration of the general anti-avoidance rule and penalties will continue to apply, although some modification and additional guidance will be necessary to reflect the changes.

6.122  The ATO will publish draft guidance on the new multinational anti-avoidance law before the end of the year and will be consulting with stakeholders on what topics they would like the guidance to cover.

6.123  The ATO is well placed to monitor the effectiveness of the multinational anti-avoidance law. Affected multinationals are likely to seek interim relief from the ATO as they seek to restructure their arrangements to comply with the law.

6.124  The ATO has indicated that it can adopt a flexible approach to administering the law for companies that are in the process of restructuring but do not have their new arrangements in place on 1 January 2016. For multinationals that voluntarily approach the ATO, penalties can be waived or reduced and specific arrangements can be made regarding compliance. This is under the Commissioner’s discretionary powers and is dependent on the relevant facts and circumstances of each case.

Country-by-Country reporting

6.125  For Country-by-Country reporting, there will be some changes required to the ATO’s existing data capture systems to process and utilise the information. The ATO will also need to prepare legislative instruments and guidance material to implement the changes. The ATO has already commenced consultations on the development of these
materials. The Government has provided the ATO with $11.3 million over the forward estimates period to undertake these activities.

6.126 The information will be managed by the ATO’s existing solid governance structures and established procedures to keep it secure. It will also be subject to the existing taxpayer secrecy laws, which apply to all tax information.

6.127 The ATO has well established teams with a proven history of delivering complex projects that enable the analysis of detailed financial information. The ATO is also well advanced in the practice of automatic exchange of information and well regarded internationally in this area.

6.128 The OECD has stated that it will review the implementation of its new documentation standards in 2020. Treasury and the ATO will examine the operation of Country-by-Country reporting in Australia in order to provide input into the OECD’s review.

**Penalties**

6.129 While minor changes to the ATO’s existing policies and procedures on the administrative penalty regime will be required, these are less urgent than for the other measures, given the straightforward nature of the changes.

6.130 As part of its response to a review by the Inspector General of Taxation, the ATO has agreed to report and publish the number and value of administrative penalties it imposes. This will allow for ongoing monitoring of how administrative penalties are being applied.
**Appendix – changes made as a result of consultations**

**Multinational Anti-Avoidance Law**

<table>
<thead>
<tr>
<th>Feedback received</th>
<th>Changes made</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Application start date</strong></td>
<td></td>
</tr>
<tr>
<td>1. Many submissions proposed that the start date be pushed back, or if the start date remains 1 January 2016, that administrative arrangements should be put in place to allow multinationals to restructure their arrangements.</td>
<td>No changes to the law. The ATO has indicated that it can adopt a flexible approach to administering the law for companies that are in the process of restructuring but do not have their new arrangements in place on 1 January 2016. For multinationals that voluntarily approach the ATO, penalties can be waived and specific arrangements can be made regarding compliance. This is under the Commissioner’s discretionary powers and is dependent on the relevant facts and circumstances of each case.</td>
</tr>
</tbody>
</table>

<p>| <strong>Connection with a low or no tax jurisdiction</strong> | |
| 2. Submissions raised concerns about the lack of clarity around key concepts used in these subsections, particularly: | Issues identified by stakeholders with this provision are no longer relevant as the provision has been removed. This simplifies the law. |
| • what is a ‘low rate’ of corporate income tax; | |
| • whether a ‘low rate of corporate income tax’ takes account of other taxes, such as mining royalties; | |
| • when is an activity ‘related, directly or indirectly’ to the supply; | |
| • what is ‘substantial economic activity’; and | |
| • the timing and content of the information to be given to the Commissioner under subsection 177DA(11). | |</p>
<table>
<thead>
<tr>
<th>Feedback received</th>
<th>Changes made</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>The purpose tests (paragraphs 177DA(1)(b) and (1)(c))</strong></td>
<td>The purposes tests in paragraphs 177DA(1)(b) and (c) were altered to ensure that there is only one test of purpose or intent with the other criteria being objective. This means that avoiding an Australian permanent establishment has been changed from being a purpose of the scheme, to a means used in the scheme for the purpose of obtaining a tax benefit, through the addition of further factors to consider under subsection 177DA(2). The examples provided in the EM have been expanded in order to provide better guidance and instruction on whether the purpose test would be satisfied.</td>
</tr>
</tbody>
</table>
| 3. Submissions raised concerns about the two-tiered purpose test. Specifically:  
  • the requirement for the taxpayer to undertake the subsection 177D(2) analysis twice: once in making an assessment about the design of the scheme and a second time in making an assessment about a person’s or persons’ purposes in entering into or carrying out schemes; and  
  • the need to satisfy the imprecise requirement of whether a corporate structure is ‘designed to avoid’ Australian tax. | Additional factors to have regard to in determining whether purpose test is satisfied (subsection 177DA(2))  
  The final Bill includes additional matters that the Commission was have regard to. The additional matters are specific to the arrangements being targeted. |
| 4. There was some concern that having regard to the relevant factors in subsection 177D(2) would not be particularly helpful in determining whether or not the purpose test under paragraphs 177DA(1)(b) and (c) would be satisfied. | **Description of the scheme (paragraph 177DA(1)(a))**  
  Non-resident and Australian resident: The concepts of ‘non-resident’ and ‘Australian resident’ have been amended to ensure include partnerships, trusts and resident entities are covered.  
  Makes a supply: The definition of supply has been modified to carve out the sale of shares, debt interests and other similar interests in order to give private equity funds clarity that they are not caught if they use Australian managers to sell Australian assets.  
  Commercially dependant on: Several submissions made suggestions for how to clarify this concept. Further guidance has been provided in the explanatory material.  
  In connection with the supply: This element has been tightened to require a ‘direct’ connection. The addition of specific factors to which the Commissioner must have regard to will also provide more guidance on the types of mischief being targeted. |
| 5. Submissions raised concerns about the lack of clarity around key terms/concepts. | **Changes made**  
  The purposes tests in paragraphs 177DA(1)(b) and (c) were altered to ensure that there is only one test of purpose or intent with the other criteria being objective. This means that avoiding an Australian permanent establishment has been changed from being a purpose of the scheme, to a means used in the scheme for the purpose of obtaining a tax benefit, through the addition of further factors to consider under subsection 177DA(2). The examples provided in the EM have been expanded in order to provide better guidance and instruction on whether the purpose test would be satisfied. |

**Table**: Feedback received and changes made to the Tax Laws Amendment (Combating Multinational Tax Avoidance) Bill 2015.
<table>
<thead>
<tr>
<th>Feedback received</th>
<th>Changes made</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Global revenue threshold</strong></td>
<td></td>
</tr>
<tr>
<td>6. Some submissions suggested changes to the threshold (for example, it should be based on tax avoided rather than revenue). Others commented on the mechanics of the provision.</td>
<td>A centrally-located definition has been created in the <em>Income Tax Assessment Act 1997</em> to refer to entities that are part of a consolidated group with annual global revenue of $1 billion. As part of this process, many of the mechanical issues were addressed.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>‘Tax benefit’ and Australian and foreign tax liabilities</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>7. Submissions queried why paragraph 177DA(3)(a) (which allows a consideration of any reduction in other Australian tax liabilities as part of the purpose test) was included. Many submissions requested more guidance on what the Australian tax benefit would be and how profits would be attributed to a notional permanent establishment.</td>
<td><strong>Deferrals:</strong> The provisions clarify that a reduction of a foreign tax liability includes a deferral of a foreign tax liability. <strong>Other Australia liabilities:</strong> Paragraph 177DA(3)(a) has been deleted as the reduction of Australian tax liabilities is covered under the concept of Australian tax benefit. <strong>Australian tax benefit:</strong> More guidance has been provided in the EM on what the expected Australian tax benefits might be.</td>
</tr>
</tbody>
</table>

**Non-confidential submissions**

- American Chamber of Commerce
- Australian Financial Markets Association
- Baker & McKenzie
- Business Council of Australia
- Booth, Alison
- Chartered Accountants Australia and New Zealand
- CPA Australia
- Deloitte
- Ernst & Young and Corporate Tax Association Joint Submission
Two confidential submissions were also received.
# Country-by-Country Reporting

<table>
<thead>
<tr>
<th>Feedback received</th>
<th>Changes made</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Content of reports</strong></td>
<td></td>
</tr>
<tr>
<td>1. A key issue raised by stakeholders was the need for clarity about the content of the reports. The need to minimise overlap with existing reporting requirements was also emphasised.</td>
<td>The ATO is working to provide guidance on the content of the reports.</td>
</tr>
<tr>
<td><strong>Transitional provisions</strong></td>
<td></td>
</tr>
<tr>
<td>2. Some stakeholders were concerned that the legislation would require the local subsidiaries of foreign multinationals to compile and lodge Country-by-Country reports ahead of the implementation of Country-by-Country reporting in the parent company’s jurisdiction.</td>
<td>The OECD clearly envisages that automatic exchange between tax authorities will be the primary mechanism for the receipt of foreign multinationals’ Country-by-Country reports. The ATO has scope under the legislation to implement practical arrangements in the transition period.</td>
</tr>
<tr>
<td><strong>Exemptions</strong></td>
<td></td>
</tr>
<tr>
<td>3. Several stakeholders requested that the exemptions envisaged in the explanatory memorandum be moved into the law. For example, the ATO should be required to provide exemptions where the information in the reports can be obtained from another tax authority or taxpayer.</td>
<td>The ATO’s power to provide exemptions has been left broad. Additional guidance has been provided in the explanatory memorandum and a power to exempt by regulation has been introduced.</td>
</tr>
<tr>
<td><strong>Timing of reports</strong></td>
<td></td>
</tr>
<tr>
<td>4. Submissions raised a number of concerns about the income periods to which the reports must relate and the timing of lodgement.</td>
<td>Additional flexibility has been introduced, including to allow the ATO to accept Country-by-Country and master file reports that relate to the income year of a parent company.</td>
</tr>
</tbody>
</table>

## Non-confidential submissions

- Association of Superannuation Funds of Australia
- Australian Bankers’ Association
- Chartered Accountants Australia and New Zealand
- Corporate Tax Association
Mr Francesco Cortellese
Deloitte
Federal Chamber of Automotive Industries
Greenwoods & Herbert Smith Freehills Pty Limited
KPMG
Minerals Council of Australia
Tax Justice Network and Public What You Pay Australia
The Tax Institute

Three confidential submissions were also received.
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<td>2.19</td>
</tr>
<tr>
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<td>2.18</td>
</tr>
<tr>
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<tr>
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<td>2.11</td>
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<tr>
<td>Item 3, subsection 960-555(2)</td>
<td>2.12</td>
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<tr>
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<tr>
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<td>Item 3, subsection 960-555(7)</td>
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</tr>
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<td>Item 3, section 960-560</td>
<td>2.13</td>
</tr>
<tr>
<td>Item 3, paragraph 960-565(a)</td>
<td>2.15</td>
</tr>
<tr>
<td>Item 3, paragraph 960-565(b)</td>
<td>2.16</td>
</tr>
<tr>
<td>Item 3, section 960-570</td>
<td>2.31</td>
</tr>
<tr>
<td>Item 3, subparagraph 960-570(a)(i)</td>
<td>2.32</td>
</tr>
<tr>
<td>Item 3, subparagraph 960-570(a)(ii)</td>
<td>2.33</td>
</tr>
<tr>
<td>Item 3, paragraph 960-570(b)</td>
<td>2.34, 2.35</td>
</tr>
<tr>
<td>Item 4, subsection 995-1(1)</td>
<td>2.36</td>
</tr>
<tr>
<td>Item 5, section 14ZVA of the Taxation Administration Act 1953</td>
<td>2.25</td>
</tr>
</tbody>
</table>
Schedule 2: Schemes that limit a taxable presence in Australia

<table>
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<th>Bill reference</th>
<th>Paragraph number</th>
</tr>
</thead>
<tbody>
<tr>
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<td>3.74</td>
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<td>Item 4, paragraphs 177DA(2)(b) and (c)</td>
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<tr>
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<td>3.80</td>
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<tr>
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<td>3.65</td>
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<tr>
<td>Item 4, subsection 177DA(5)</td>
<td>3.84</td>
</tr>
<tr>
<td>Item 7</td>
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## Schedule 3: Scheme penalties for significant global entities

<table>
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<th>Bill reference</th>
<th>Paragraph number</th>
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</thead>
<tbody>
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<td>Item 1, subsection 284-155(3)</td>
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<td>Item 1, paragraph 284-155(3)(a)</td>
<td>4.9</td>
</tr>
<tr>
<td>Item 1, paragraph 284-155(3)(b)</td>
<td>4.11</td>
</tr>
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## Schedule 4: Country-by-country reporting

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