Australian Update

Introduction

Over the past 12 months, Australia has further enacted and proposed a raft of measures directly aimed at multinationals and foreign residents. This is amidst the backdrop of the Multinational Ant-Avoidance Law (**MAAL**) applying from 1 January 2016.

This paper provides an overview of recent measures, including:

1. The MAAL which commenced on 1 January 2016;
2. Announcement of a Diverted Profits Tax commencing 1 July 2017;
3. a new "Tax Avoidance Taskforce" which will enhance audit activity for large corporates and high wealth individuals;
4. GST on cross border supplies of intangibles and goods to Australian consumers;
5. Announcement that the OECD's recently updated Transfer Pricing Guidelines will be implemented in Australia and the implementation of Country-by-Country reporting in Australia;
6. New withholding tax regime on disposals by foreign residents of certain taxable Australian property;
7. Stamp duty surcharge on foreign buyers of Australian property; and
8. The company tax rate was slated to be reduced, however this is subject to on-going debate.

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1. Multinational Anti-avoidance Law

The MAAL applies from 1 January 2016 to entities that are part of a global group with annual global income of A$1 billion (approximately $US750m) or more (determined on an accounting consolidated group basis), where a foreign entity in the group makes supplies to Australian customers whilst avoiding the attribution of income to an Australian PE.

Key requirements for the MAAL to apply

Broadly, the requirements for the MAAL to apply are:

- a foreign entity makes a supply to its Australian customer (the **supply test**);
- activities are undertaken in Australia directly in connection with the supply (the **Australian activities test**);
- some or all of those activities are undertaken by an Australian entity who is an associate of or is commercially dependent on the foreign entity, or undertaken at or through an Australian PE of an entity who is an associate of or is commercially dependent on the foreign entity (the **associate / dependence test**);
- the foreign entity derives ordinary income, or statutory income, from the supply (the **income test**);
- some or all of that income the foreign entity derives from the supply is not attributable to an Australian PE of the foreign entity (the **non-attribution test**);
- it would be concluded that the person/s entered into or carried out the scheme for a principal purpose of, or for more than one principal purpose that included a purpose of, avoiding Australian tax or avoiding both Australian tax and a foreign tax (the **principal purpose test**); and
- the foreign entity is part of a global group with annual global income of A$1 billion or more (determined on an accounting consolidated group basis) for the income year in which a taxpayer would obtain an Australian tax benefit or reduce one or more of their foreign tax liabilities (the **significant global entity test**).

What happens if the MAAL applies

If the MAAL applies, the relevant entity may be subject to:

- Australian income tax liability, as a result of the Commissioner cancelling any Australian tax benefits obtained in connection with the scheme;

- Australian withholding tax liability, as a result of (for example) the Commissioner finding a reasonable alternative transaction would have involved an Australian PE paying a royalty to an offshore intellectual property holder;
- interest; and
- increased penalties of up to 120% of the Australian income tax liability.

The MAAL operates within the Australia's domestic general anti-avoidance rules. Section 4(2) of the *International Tax Agreements Act 1953* (Cth) provides that Australia's domestic general anti-avoidance rules override the operation of any Australian tax treaties. This means that, if the MAAL applies, the Commissioner will argue that taxpayers cannot raise any treaty defences in order to be exempted from Australian tax.

Taxpayers across the board have been subject to on-going engagements with the Australian Tax Office (**ATO**) since 1 January 2016, spending a significant amount of time and effort discussing potential restructures to their Australian supply chains, so as to be MAAL compliant. In the midst of these discussions, the Australian Government announced a Diverted Profits Tax (discussed below).

2. Diverted Profits Tax (DPT)

As part of the 2016-17 Federal Budget, the Australian Government announced a DPT which is scheduled to commence from 1 July 2017, however to date, there has been no draft legislation released.

According to the Consultation Papers released as part of the Federal Budget, the Australian DPT is "*designed to ensure entities operating in Australia cannot avoid Australian tax by transferring profits, assets or risks offshore through related party transactions that lack economic substance, and to discourage multinationals from delaying the resolution of transfer pricing disputes*". This is described as the Australian equivalent to the second limb of the UK DPT.

The DPT will apply to income years commencing on or after 1 July 2017 whether or not a relevant transaction was entered into before that date.

Significant global entities

Consistent with the MAAL, it will only apply to significant global entities with annual global income of A$1 billion or more (on a consolidated accounting basis).

As an improvement on the MAAL, a de-minimis threshold will exempt entities with Australian turnover of less than A$25 million (unless revenue is artificially booked offshore rather than in Australia). This aligns with the exemption for small taxpayers applying simplified transfer pricing record-keeping requirements (and hopefully will be extended to the MAAL soon).

When will it apply?

An arrangement with a related party may be subject to the DPT if:

- the transaction has given rise to an *effective tax mismatch*; and

- the transaction has *insufficient economic substance*.

If the related party arrangement gives rise to an effective tax mismatch, and has insufficient economic substance, the ATO may issue a *DPT assessment*. The assessment will be calculated by reference to the total of the *Diverted Profits Amount* multiplied by the *DPT rate*.

What is an effective tax mismatch?

An effective tax mismatch will exist where an Australian taxpayer has a cross-border transaction with a related offshore party and, as a result, the increased income tax liability offshore attributable to the transaction is less than 80% of the corresponding reduction in Australia.

Insufficient substance test

Determination of whether there is insufficient economic substance will be based upon whether it is reasonable to conclude based on the information available at the time to the ATO that the transaction(s) was *designed to secure the tax reduction*. This is a vague test in an Australian context. Further guidance in the Consultation Paper notes that "*Where the non-tax financial benefits of the arrangement exceed the financial benefit of the tax reduction, the arrangement will be taken to have sufficient economic substance*".

DPT rate

The DPT rate will be 40% of the Diverted Profit Amount. Interest will be charged from the date tax would have been otherwise payable if the scheme had not been entered into. The DPT will not be deductible or creditable in Australia.

In calculating the DPT, an offset will be allowed for any Australian taxes paid on the diverted profits (e.g. Australian withholding taxes and Australian tax paid under the Controlled Foreign Company regime). However, there are no credits for foreign tax.

Process and review

The payment of tax has been accelerated compared with an ordinary review process for a risk review or audit.

Initially, a provisional DPT assessment may be issued by the ATO on review of a tax return (it is not a self assessment regime). That assessment will be issued as soon as practicable after the end of an income year and no later than seven years after the taxpayer has lodged its income tax return for the relevant year.

The taxpayer will then have only 60 days to make representations to correct factual matters set out in the provisional DPT assessment (but not on transfer pricing matters). Following this, the ATO will issue a final DPT assessment within 30 days and the taxpayer will have 21 days to pay the assessment and has no right of appeal against the final DPT assessment at this stage. That is, the tax payment is accelerated prior to the complete review.

The ATO will have 12 months to review the final DPT assessment, during which time the taxpayer may provide information to the ATO to support an amendment to the DPT assessment, which may include an adjustment on transfer pricing grounds. During this period, if the ATO considers the amount of DPT charged to be insufficient, the ATO may issue a supplementary DPT assessment up to 30 days prior to the end of the review period to impose an additional charge of DPT.

At the completion of this 12 month review, the taxpayer has 30 days to lodge an appeal through the courts.

3. ATO Taskforce

The Australian Government announced in May 2016 that it will establish a new Tax Avoidance Taskforce to enable the ATO to undertake enhanced compliance activities targeting multinationals, large public and private groups and high wealth individuals.

This measure provides the ATO with a 55% increase in funding for compliance programs targeting multinationals and high wealth individuals. It specifically provides that it includes a 43 % increase in resources devoted to tackling multinationals (including ramping up to an additional 390 average staffing level per year.

This measure is estimated to have a gain to revenue of A$3.7 billion over the forward estimates period. No doubt two of the targeted areas of compliance will centre on the MAAL and DPT.

4. GST changes: foreign vendors will be subject to GST on inbound supplies of intangibles and goods

Inbound supplies of goods - low value threshold to be removed

To date, GST at the rate of 10% only applies to the importation of goods in Australia with a value of AU$1,000 or more. As a consequence, online sales of goods made by offshore vendors are generally not subject to GST when made to Australian consumers.

However, the abovementioned l threshold is slated to be removed in its entirety and replaced with a vendor collection model.

The Australian Government released a statement that the Australian States and Territories have agreed to broaden the Australian GST to cover overseas online transactions of goods under AU$1,000. The proposal broadly relies on a vendor registration model as a method of collecting the GST and will remove the existing threshold for goods to zero.

Draft legislation has not yet been released. The Treasurer announced that the Government will draft legislation for the application of the new arrangements effective from 1 July 2017.

Inbound supplies of intangibles / digital services

To date, offshore sales of digital content and intangibles to Australian consumers have generally fallen outside of Australia's GST net (for example, online streaming and e-books sold by an offshore vendor).

However, specific rules were announced to bring such supplies within Australia's GST net. In this regard, the Australian Government announced the specific measures in the 2015-2016 Federal Budget to impose Australian GST at the standard rate of 10% on the offshore supply of intangibles to Australian consumers.

The new measures were released as the *Tax Laws Amendment (2016 Measures No. 1) Bill 2016* and was passed by the Australian Parliament on 4 May 2016, receiving Royal Assent on 5 May 2016.

As a result of the measures, a new taxing nexus has been introduced into the *A New Tax System (Goods and Services Tax) Act 1999* The taxing net will apply to the supply of "anything other than goods or real property supplied from outside Australia to an Australian consumer".

The new measure will apply from 1 July 2017. The changes are broadly in line with BEPS Action 1 (Addressing the Tax Challenges of the Digital Economy) and applies the principles put forward in the OECD's International VAT/GST Guidelines. It aims to tax where the final consumption occurs, thereby maintaining neutrality within the GST system as it applies to international trade.

5. Endorsement of TP Guidelines and introduction of Country by Country (**CbC**) reporting

TP Guidelines

Australia has announced that it will amend its transfer pricing rules to ensure that the latest OECD Transfer Pricing Guidelines will apply in Australia, effective from 1 July 2016.

The OECD has substantially revised its transfer pricing guidance, particularly in relation to the recognition and pricing of intellectual property and other intangible assets, as well as a more detailed framework for assessing and allocating risks between related parties. This new guidance enhances the ATO's ability to challenge transfer pricing arrangements which ascribe substantial value to intangible assets held outside of Australia. Even where such arrangements fall outside of the MAAL and proposed DPT, taxpayers need to closely review and monitor the transfer pricing position of their Australian operations in the context of their global value chain, in order to ensure that the principles of the new guidance are fully reflected in their intercompany relationships.

CbC Reporting

Under CbC reporting, multinationals operating in Australia with an annual global income of AUD 1 billion or more are required to give the ATO certain reports about their global financial activities.

These entities will now be required to provide the following statements to the ATO:

- CbC report (global summary of key metrics), which should include the following information for each country in which the multinational group operates: revenue, profit (loss) before income tax, income tax paid, income tax accrued, stated capital, accumulated earnings, tangible assets, number of employees and main business activity;

- a master file (global group overview), which provides an overview of the group's global business, its organizational structure and its transfer pricing policies; and

- a local file (Australian operations only), which contains detailed information about the local taxpayer's operations and intercompany transactions.

CbC reporting applies to income years starting on or after 1 January 2016. An Australian entity that is required to lodge CbC reports with the ATO must do so electronically within 12 months of the end of the relevant accounting period.

An entity can apply to the ATO for an exemption with respect to some or all of its CbC reporting obligations. However, whether an exemption is granted is subject to the ultimate discretion of the Commissioner of Taxation and is not automatic. There is also a variety of factors the Commissioner of Taxation can take into account when deciding whether to grant an exemption.

Importantly, the requirement to provide a CbC report, masterfile and Australian local file does not replace the existing Australian transfer pricing documentation requirements.

To achieve transfer pricing penalty protection, Australian entities must continue to ensure that they have full transfer pricing documentation in existence at the time of lodging the relevant Australian tax return, which is generally around **6 months after year end**. Transfer Pricing documentation is not required to be supplied to the ATO unless requested.

From an efficiency standpoint, Taxpayers may wish to prepare their Australian masterfile and local file under an accelerated timeframe so that it may also serve as transfer pricing documentation capable of supporting the tax return filing position of any Australian subsidiaries, thereby providing transfer pricing penalty protection.

6. Foreign resident withholding tax

From 1 July 2016, a 10% withholding tax applies to disposals by foreign residents of certain taxable Australian property. This measure does not apply to residential property transactions under $2.5 million or to disposals by Australian residents.

Broadly, the new regime imposes an obligation on any entity that acquires the following classes of asset off-market from a non-resident to pay 10% of the purchase price to the ATO:

- land in Australia and other kinds of real property such as leases over land in Australia or contracts for the sale of land in Australia;
- mining, quarrying or prospecting rights relating to minerals or oil in Australia;
- shares or units representing more than 10% of an entity; and
- a right or option to acquire any of the above.

The buyer's obligation is generally triggered if any one of 4 conditions is met:

- the buyer knows that the seller is a foreign resident; or
- the buyer reasonably believes that the seller is a foreign resident; or
- the seller has given to the buyer an address outside Australia; or
- the seller has authorised the buyer to pay an amount to a place outside Australia.

The amount must be paid to the ATO on or before the day on which the buyer becomes the owner of the asset unless certain exemptions apply. For example, where the seller of shares or units provides a declaration (broadly, that the entity being sold does not derive its value principally from interests in land or certain other kinds of property in Australia). There is also a mechanism allowing a clearance certificate to be sought from the ATO in certain situations.

The amount remitted by the buyer (which is based on the gross price payable) is effectively a pre-payment of the seller's actual tax liability (based on the net amount of income or net capital gain). Existing provisions will give the seller a credit toward its tax liability for the amount remitted by the buyer.

7. Foreign resident stamp duty surcharge

State budgets for 2016 in three Australian States namely, Queensland, New South Wales and Victoria, announced far reaching changes to stamp duty on land purchases by foreign purchasers (effectively applying a 3% - 7% of surcharge duty in addition to the existing duty rates).

Accordingly, where a foreigner purchases residential property, higher rates of duty than those applying to local purchasers will be payable.

8. Company tax rate to be cut to 25% by 2026

The 2016-2017 Federal Budget promised a staged reduction in the corporate tax rate from the current 30% (28.5% for small businesses) to 25% over the next 10 years. Franking credits are to be distributed at the rate of tax paid by the company. However, this measure has not yet been passed and is subject to on-going debate.