Chapter 1

Background to the inquiry

1.1 On 17 September 2015, the Senate referred the provisions of the Tax Laws Amendment (Combating Multinational Tax Avoidance) Bill 2015 (the bill) to the Senate Economics Legislation Committee for inquiry and report by 9 November 2015.[1]

1.2 Schedule 1 of the bill would amend 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 the bill as part of the 'combating multinational tax avoidance' package announced in the 2015–16 Budget.[2]

1.3 Schedule 2 of the bill would amend the anti-avoidance provisions in the *Income Tax Assessment Act 1936* to introduce the multinational anti-avoidance law (MAAL). The MAAL 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 profit to Australia through a taxable presence in Australia.[3]

1.4 Schedule 3 of the bill would amend the *Tax 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.[4]

1.5 Schedule 4 of the bill would implement Action 13 of the G20 and the Organisation for Economic Cooperation and Development's (OECD's) *Action Plan on Base Erosion and Profit Shifting*, which concerns transfer pricing documentation and Country-by-Country reporting, into Australian law.[5]

1.6 This chapter outlines the background of the bill, provides an overview of each schedule separately, and summarises the consultation process.

Conduct of the inquiry

1.7 The committee advertised the inquiry on its website and wrote to a range of individuals and organisations inviting written submissions. The committee received 16 submissions, which are listed at Appendix 1.

1.8 The committee thanks all who contributed to the inquiry.

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1 *Journals of the Senate*, No. 118, 17 September 2015, p. 3146.

2 *Explanatory Memorandum*, p. 7.

3 *Explanatory Memorandum*, pp. 7–8.

4 *Explanatory Memorandum*, p. 9.

5 *Explanatory Memorandum*, p. 10.

Background to the bill

1.9 Corporate tax avoidance is a significant concern to the general public and governments globally. Recognising this, governments have been proactively supporting the development of coordinated solutions to address issues associated with multinational taxation through the G20 and the OECD.

1.10 The Australian Government is taking a lead role in the push for multinationals to pay their fair share of tax and is committed to G20/OECD's Base Erosion and Profit Shifting (BEPS) project, which aims to restore fairness in the international tax system and ensure that entities pay tax where they have earned profits.[6]

1.11 As President of the G20 in 2014, Australia led progress on the BEPS action plan. The then Treasurer, the Honourable Joe Hockey MP, emphasised that:

> …the Government is committed to a fair and efficient tax system.
>
> We are determined that multinational tax payers will not be able to avoid their Australian tax obligations by shifting their international profits to low tax or no tax jurisdictions…
>
> We will continue to monitor our domestic laws in response to the changing international economy, and make sure they remain effective in countering arrangements designed to shift profits out of Australia.[7]

1.12 The rhetoric to combat multinational tax avoidance was supported by a package of measures in the 2015–16 Budget. This package included action on four of the 2014 BEPS recommendations, namely:

- 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.[8]

1.13 The government also noted that, while the OECD work was essential, immediate action was required to ensure that Australia's tax laws were fit to deal with the most egregious tax avoidance arrangements. Accordingly, the 2015–16 Budget included a number of domestic measures, including:

- introducing a MAAL to strengthen the existing tax avoidance laws;

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6 *Explanatory Memorandum*, p. 13.

7 *Ministerial Statement on G20-OECD Tax and Transparency*, Speech 14-2014, 4 September 2014, http://jbh.ministers.treasury.gov.au/speech/014-2014/ (accessed 12 October 2015).

8 *Explanatory Memorandum*, p. 13.

- 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.[9]

1.14 This bill implements the MAAL, increased penalties and the G20/OECD's BEPS recommendation on Country-by-Country reporting for companies that are considered to be significant global entities.[10]

1.15 According to the Explanatory Memorandum, 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 approach is consistent with the government's commitment to deregulation and supporting small business, and with the recommended approach of the G20/OECD on Country-by-Country reporting.[11]

Schedule 1: Significant Global Entity

1.16 The package of measures in this bill is targeted at entities that are part of multinational groups that earn significant amounts of income worldwide. The definition of a significant global entity is used to determine which groups are captured by the other measures in the bill.[12] However, no such concept currently exists in tax law that adequately captures the definition of a significant global entity.

1.17 Accordingly, the bill introduces a new concept into tax law that can give clarity to taxpayers about whether they are within scope of the measures to which this definition applies. It does this through amending 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. Specifically, Schedule 1 inserts a new concept into Division 960 of the ITAA 1997 to allow for each measure of the bill to reference a centralised definition of significant global entity.[13]

1.18 A significant global entity is defined as:

- a 'global parent entity' with 'annual global income' of A$1 billion or more; or
- 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 A$1 billion or more.[14]

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9 *Explanatory Memorandum*, p. 14.

10 *Explanatory Memorandum*, p. 14.

11 *Explanatory Memorandum*, p. 15.

12 *Explanatory Memorandum*, p. 15.

13 *Explanatory Memorandum*, pp. 15-16.

14 *Explanatory Memorandum*, p. 16.

1.19 The bill relies on a number of other definitions—that is, 'global parent entity', 'annual global income' and 'global financial statements'—in order to define a 'significant global entity'.

1.20 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 to the commercial entity, commercially accepted principles related to accounting. A global parent entity would usually be a member of a group of entities where the global parent entity is one that is not controlled by any other entity. Subsidiaries of the global parent entity may be located in other jurisdictions. However, it is possible that a global parent entity may be a single entity that does not control any other entities.[15]

1.21 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 the period. Where the global parent entity is a member of a single group of entities that are consolidated for accounting purposes, the global parent entity's 'annual global income' for a period is the total of the annual global income amounts of the consolidated group.[16]

1.22 When calculating the annual global income, it may be necessary to translate amounts into Australian currency. For the purposes of this bill, the currency conversion would be completed on the basis of the average exchange rate for the period which the statements are prepared. The entity is required to obtain exchange rates to develop an average exchange rate for the period, either from one or more sources that are not associates of the entity or from sources specified by the Commissioner of Taxation (Commissioner) in a notice to the entity. The notice from the entity would not be a legislative instrument.[17]

1.23 Some global parent entities may not be required to prepare a global financial statement. The bill would allow the Commissioner to 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 A$1 billion or more. In such circumstances, the Commissioner would be required to give notice of the determination to the global parent entity or to an entity that becomes a significant global entity as a result of the determination. The Commissioner's determination would not be a legislative instrument. The determination is reviewable but objections cannot be made with respect to procedural irregularities in the process of making the determination and must instead be made on substantive grounds.[18]

1.24 'Global financial statements' of an entity are the financial statements that have been prepared in accordance with accounting principles and auditing principles which ensure the statements give a true and fair view of the financial position and

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15 *Explanatory Memorandum*, p. 17.

16 *Explanatory Memorandum*, p. 17.

17 *Explanatory Memorandum*, pp. 18-19.

18 *Explanatory Memorandum*, pp. 19-20.

performance of the entity (or the entity and the other entities on a consolidated basis).[19]

Schedule 2: Multinational anti-avoidance law

1.25 Schedule 2 is intended to 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 booking their revenue offshore despite undertaking significant work in Australia with direct connection to Australian sales; and
- have a principle purpose of avoiding tax in Australia or reducing their foreign tax liability.[20]

1.26 The measure clarifies that a limited and clearly egregious set of circumstances involving sales to Australian customers by foreign multinationals are considered to be tax avoidance.[21]

1.27 The bill amends anti-avoidance rules in Part IVA of the *Income Tax Assessment Act 1936* (ITAA 1936) to negate certain tax avoidance schemes used by multinational entities to artificially avoid the attribution of profits to a permanent establishment in Australia. Schedule 2 inserts section 177DA into the ITAA 1936 to define schemes that limit a taxable presence in Australia and makes a number of consequential amendments to section 177 and subparagraph 284–145 of the *Taxation Administration Act 1953*.

1.28 The MAAL does not limit the application of the existing anti-avoidance rule in Part IVA, and accordingly section 177D of the ITAA can still apply to schemes involving permanent establishments. The MAAL would only apply to foreign entities that are significant global entities.[22]

1.29 The MAAL will apply to a scheme if under, or in connection with, the scheme:

- a foreign entity makes certain supplies to an Australian customer;
- activities are undertaken in Australia directly in connection with the supply;
- 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;
- the foreign entity derives ordinary or statutory income from the supply; and

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19 *Explanatory Memorandum*, p. 20.

20 *Explanatory Memorandum*, p. 23.

21 *Explanatory Memorandum*, p. 24.

22 *Explanatory Memorandum*, p. 24.

- some or all of that income is not attributable to an Australian permanent establishment of the foreign entity.[23]

1.30 For the measure to apply, the scheme must involve activities being undertaken in Australia that are directly connected with the supply to Australian customers. Some or all of the activities connected with the supply to Australian customers need to be undertaken by an Australian entity or undertaken at or through an Australian permanent establishment of an entity. The measure will only apply to schemes where the Australian entity (or the 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.[24]

1.31 The measure applies a purpose test that is satisfied if it would be concluded, having regard to certain matters, 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. This includes the deferral of a taxpayer's liabilities to tax under a foreign law unless there are reasonable commercial grounds for the deferral.[25]

1.32 The Commissioner will have regard to whether certain matters apply to satisfying the purpose test, including those matters listed in subsection 177D(2) that apply to the general anti-avoidance law, and two additional matters that consider factors specific to the kinds of schemes intended to be caught by the measure. The first additional matter is that regard must be had to the extent to which the activities that contribute to bringing about the contract for supply are performed, and are able to be performed by: the foreign entity; an Australian-based entity; or, any other entities. The second additional matter 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.[26]

1.33 Where a scheme is captured by the MAAL, the Commissioner has the power to make a determination under Part IVA of the ITAA 1936 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. The quantum of tax benefit obtained under the scheme will depend on the facts and circumstances of the case. It is likely, however, to include the ordinary and statutory income from the supply that would have been attributable to an Australian permanent establishment of the foreign entity, subject to any compensating adjustments allowing for deductions. The quantum of the tax benefit obtained would also take into account obligations arising under Australia's royalty and interest withholding tax rules.[27]

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23 *Explanatory Memorandum*, pp. 26–27.

24 *Explanatory Memorandum*, pp. 29–31.

25 *Explanatory Memorandum*, pp. 32 and 35.

26 *Explanatory Memorandum*, pp. 36–39.

27 *Explanatory Memorandum*, p. 25.

1.34 The Explanatory Memorandum includes a direct comparison of the key features of the new law and the current law, which is reproduced below in Table 1.1.[28]

Table 1.1: Comparison of key features of new law and current law in Schedule 2

New law	***Current law***
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.	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.

Schedule 3: Scheme penalties for significant global entities

1.35 Schedule 3 is intended to help deter tax avoidance by increasing the maximum administrative penalties that can be applied by the Commissioner to large multinationals which enter into tax avoidance or profit shifting schemes.[29]

1.36 The bill amends section 284–155 of the *Tax Administration Act 1953* to double the penalty imposed for entering into a tax avoidance or profit shifting scheme for significant global entities that do not have a reasonably arguable position. The amendments do not apply to taxpayers who have a reasonably arguable position on the application of the relevant adjustment provision.[30]

1.37 The Explanatory Memorandum provides a table that sets out the new penalties that apply under the measure, which is reproduced in Table 1.2.[31]

28 *Explanatory Memorandum*, p. 25.

29 *Explanatory Memorandum*, p. 53.

30 *Explanatory Memorandum*, pp. 54–55.

31 *Explanatory Memorandum*, p. 56.

Table 1.2: Scheme penalty amounts for significant global entities
Penalties as a percentage of tax avoided

Culpable behaviour	*Base penalty amount*	*Aggravating factors apply*	*Disclosure during examination*	*Disclosure before examination*
Tax avoidance schemes* [if position is reasonably arguable]	100 [25]	120 [30]	80 [20]	20 [5]
Profit-shifting schemes [if position is reasonably arguable]	50 [10]	60 [12]	40 [8]	10 [2]

* 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.

1.38 The Explanatory Memorandum includes a direct comparison of the key features of the new law and the current law, which is reproduced below in Table 1.3.[32]

Table 1.3: Comparison of key features of new law and current law in Schedule 3

New law	*Current law*
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.	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).

Schedule 4: Country-by-Country reporting

1.39 Australia's transfer pricing rules seek to ensure that an appropriate return for the contribution made by the Australian operations of a multinational is taxable in Australia. These rules provide a legislative framework, based on the arm's length

32 *Explanatory Memorandum*, p. 54.

principle, which ensures that an entity's tax position is consistent with that of an independent entity dealing wholly independently with others.[33]

1.40 Action 13 of the BEPS Action Plan recognises that enhancing tax transparency for tax administrations, by providing them with adequate information to conduct transfer pricing risk assessments, is an essential part of tackling profit shifting.

1.41 The G20/OECD report on Action 13, *Guidance on Transfer Pricing Documentation and Country-by-Country Reporting*, sets out revised standards for transfer pricing and recommends that jurisdictions require multinationals to provide information through three reports—a 'CbC' report, a 'master file', and a 'local file'. These reports will provide a clear overview of key financial and operational metrics relevant to a global group, as well as their Australian operations. As such, it will assist the ATO and other tax authorities to assess transfer pricing risks and, when necessary, to commence and target audit enquiries.[34]

1.42 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 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.[35]

1.43 The OECD envisages that CbC reports will be automatically exchanged between jurisdictions. This means that CbC reports will be filed in the jurisdiction of the global parent entity and automatically exchanged with tax authorities in other jurisdictions in which the group operates. Australia envisages making CbC reports filed in Australia available for exchange under such arrangements, and receiving CbC reports from other jurisdictions.[36]

1.44 This measure implements Action 13 of the BEPS Action Plan by inserting subdivision 815-E (Reporting obligations for significant global entities) into

33 *Explanatory Memorandum*, p. 59.

34 *Explanatory Memorandum*, p. 60

35 *Explanatory Memorandum*, p. 63.

36 *Explanatory Memorandum*, p. 60.

Division 815 of the *Income Tax Assessment Act 1997*. The subdivision requires significant global entities that are Australian residents or foreign residents with an Australian permanent establishment to provide a CbC report, a master file and a local file to the Commissioner in an approved form within 12 months of the end of the income year to which the statement relates.[37]

1.45 The Commissioner may allow an entity to submit one or more statements in relation to a 12 month period other than an income year. This allows 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).[38]

1.46 The Commissioner may also exclude specific entities from having to provide a statement depending on the risk profile of the local entity, the compliance burden and whether the relevant statement(s) will be received by alternative means (such as through automatic exchange of information provisions).[39]

1.47 The Explanatory Memorandum includes a direct comparison of the key features of the new law and the current law, which is reproduced below in Table 1.4.[40]

Table 1.4: Comparison of key features of new law and current law in Schedule 4

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

37 *Explanatory Memorandum*, p. 61.

38 *Explanatory Memorandum*, p. 62.

39 *Explanatory Memorandum*, p. 62.

40 *Explanatory Memorandum*, p. 61.

Consultation on the bill

1.48 As noted above, the 2015–16 Budget announced the government's intention to introduce a MAAL, CbC reporting and stronger penalties for multinational tax avoidance.[41]

1.49 An exposure draft of the multinational anti-avoidance law was released on 12 May 2015 by Treasury and submissions were invited. Treasury received 20 submissions by the closing date of 9 June 2015, of which 2 were confidential.[42]

1.50 An exposure draft of the Country-by-Country reporting and stronger penalties was released on 6 August 2015 and submissions were invited. Treasury received 15 submissions by the closing date of 2 September 2015, of which 3 were confidential.[43]

1.51 The Explanatory Memorandum indicates that a number of changes were made to the measures as a result of the consultation process.[44]

41 *Budget 2015: Fairness in Tax and Benefits*, pp. 7–8.

42 Treasury, *Tax Integrity: Multinational Anti-avoidance Law*, http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2015/Tax-Integrity-Law (accessed 15 October 2015).

43 Treasury, *Multinational tax avoidance - Country-by-Country reporting and stronger penalties*, http://www.treasury.gov.au/ConsultationsandReviews/ Consultations/2015/Multinational-tax-avoidance (accessed 15 October 2015).

44 *Explanatory Memorandum*, p. 89.