KPMG submission

Senate Economics Legislation Committee

Tax Laws Amendment (Combating Multinational Tax Avoidance) Bill 2015

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Executive Summary

KPMG welcomes the opportunity to comment on the *Tax Laws Amendment (Combating Multinational Tax Avoidance) Bill 2015* as introduced into the House of Representatives on 16 September 2015.

We have the following key observations and recommendations. Our detailed comments are set out in the Appendices.

Supporting international consensus, rather than unilateral action, benefits Australia in the long term

We begin with some general observations.

International consensus facilitates global solutions to global issues. It is likely to reduce the compliance burden and promote growth.

By remaining 'in the fold', Australia encourages other countries to do the same. This promotes international consensus. And it maintains Australia's reputation in both global (G20 and OECD) and regional forums, protecting the interests of Australian groups. These are not factors to be ignored.

With this in mind, we support Australia's adoption of country by country (CbC) reporting, a measure the OECD and G20 have endorsed.

However, we believe Australia's introduction of a multinational anti-avoidance law (MAAL) may help create a harmful international precedent – that of addressing international tax issues unilaterally, rather than adopting globally coordinated measures – and damage international consensus.

We would instead have advocated addressing the artificial avoidance of 'permanent establishment' status using the changes proposed by Action 7 of the BEPS Action Plan to that term's treaty definition.

We now make the following specific comments.

Country by country (CbC) reporting

We support the proposal to introduce CbC reporting. This is consistent with our view to follow international consensus. We recommend two minor changes:

- Exempting large domestic groups with small cross-border activities and large multinational enterprises with small Australian operations.
- Clarifying the definition of 'significant global entity' (in Appendix 1, we suggest specific changes).

Multinational anti-avoidance law (MAAL)

We expect the MAAL will change how many of the targeted (now) 80 multinationals operate in Australia. However, it will also affect numerous other multinational groups, increasing the compliance burden and reducing certainty.

We believe the MAAL is currently drafted more widely than needed to achieve its stated aim. We recommend confirming the MAAL's intended narrow operation by aligning the avoidance threshold in the Bill with the existing thresholds employed by Australia's general anti-avoidance rules. There are currently two such thresholds: the 'sole or dominant purpose' threshold, and the 'more than incidental purpose' threshold. As currently drafted, the Bill introduces a third threshold: that of a 'principal purpose'. By doing so, it introduces further complexity and uncertainty – in circumstances where we should be seeking to simplify Australia's tax law. In addition, we believe the lower threshold is unnecessary given the MAAL permits the Commissioner to take into account foreign tax benefits. We therefore recommend that the MAAL should use the existing 'sole or dominant purpose' test.

Need for guidance

Numerous aspects of the Bill require further guidance. Appendix 2 lists ten key topics that would benefit from consultation.

Post-implementation review

It will be important to align Australia's domestic implementation of the CbC initiatives with the OECD Implementation Guidance so as to maximise the compliance benefits of standardised global reporting and minimise the compliance costs for multinational enterprises.

In addition, several future events (eg deliverables from the OECD BEPS process) may affect the measures' application.

We recommend scheduling a post-implementation review.

Appendix 1: Detailed comments

1. Country by country (CbC) reporting

1.1. We recommend exempting large domestic groups with small cross-border activities and large multinational enterprises with small Australian operations.[1] The levels set by such a *de minimis* rule should be considered by Treasury in consultation with the ATO. We have recommended a threshold of 0.2% of total annual income for both an inbound and an outbound *de minimis* rule. While this could be dealt with at the administrative level it would be preferable if it were embodied in the legislation itself.

1.2. The measures in the Bill apply only to a 'significant global entity', a term defined by reference to 'total annual income'.[2]

1.3. The words 'total annual income' introduce uncertainty. They do not appear in the Australian Financial Reporting Standards (AIFRS) and have no defined meaning. (The Framework for the Preparation and Presentation of Financial Statements defines 'income' but only in a conceptual manner.)

1.4. We therefore recommend adopting a replacement term such as 'consolidated revenue'. The latter appears in the *Corporations Act 2001* (Cth) definition of 'large proprietary company'[3] and, in our view, is measured in accordance with AASB 118 *Revenue*.

1.5. For multinationals that are headquartered overseas and prepare consolidated accounts using foreign accounting standards such as US GAAP, further guidance is needed (eg confirmation of relevant line items).

2. Multinational anti-avoidance law (MAAL)

2.1. The Explanatory Memorandum suggests the MAAL is intended to target 'a limited and clearly egregious set of circumstances'[4] under which multinational entities 'artificially avoid' the attribution of profits to a permanent establishment in Australia.[5]

[1] KPMG, 'Exposure Draft – Tax Laws Amendment (Tax Integrity Multinational Anti-avoidance Law) Bill 2015: Country by country reporting' (Submission, 31 August 2015).
[2] *Income Tax Assessment Act 1997* (Cth) s 960-565.
[3] *Corporations Act 2001* (Cth) s 45A.
[4] Paragraph 3.7 of the Explanatory Memorandum.
[5] Paragraph 3.8.

2.2. Originally, 30 multinationals were targeted.[6] This has now been increased to 80.

2.3. We expect the MAAL will change how those 80 multinationals operate in Australia.

2.4. However, we expect the MAAL will also affect numerous other multinational groups whose arrangements are neither artificial nor 'clearly egregious'. Many such groups will have to demonstrate that obtaining an Australian or foreign tax benefit was not one of their *principal* purposes.

2.5. Until now, Australia's general anti-avoidance rules (Part IVA) have used a consistent 'sole or dominant purpose' threshold for avoidance. (There is one exception: a specific franking credit anti-avoidance provision.)

2.6. Introducing a new 'principal purpose' threshold has pros and cons.

2.7. The arguments against introducing the new threshold are as follows:

(1) Introducing a new 'principal purpose' avoidance threshold increases complexity and uncertainty.

a. In March 2015, Re:think (the tax discussion paper) observed: 'Our tax system is too complex'.[7] One reason identified was 'the regular "patching" of the law to fix narrow problems'.[8]

b. Adding another purpose test to our anti-avoidance provisions in circumstances where we should be trying to simplify the legislation is undesirable. It would be preferable to adopt a consistent avoidance threshold for all anti-avoidance matters, rather than introduce a new threshold altogether.

c. In addition, the application of the 'principal purpose' test is inherently uncertain. The Explanatory Memorandum equates 'principal' with 'main'.[9] However, the courts may disagree with this conclusion: From an etymological perspective, other possible meanings of 'principal' include 'primary' and 'first in order of importance'. Indeed, the courts are likely to

[6] Joe Hockey, 'Strengthening our taxation system' (Media Release, 4/2015, 11 May 2015) <http://jbh.ministers.treasury.gov.au/media-release/040-2015/>.
[7] Tax White Paper Task Force, Treasury, *Re:think – Tax Discussion Paper* (2015) 2 <http://bettertax.gov.au/files/2015/03/TWP_combined-online.pdf>.
[8] Ibid.
[9] Paragraph 3.57 of the Explanatory Memorandum.

take many years to determine conclusively how a new threshold applies (as was the case with the existing 'dominant purpose' threshold).

(2) Introducing a new 'principal purpose' test is unnecessary to achieve the MAAL's stated aim.

a. Unlike the existing anti-avoidance provisions in Part IVA, the MAAL will require consideration of foreign tax benefits in addition to Australian tax benefits. Once foreign tax benefits are taken into account, we believe it is unnecessary to lower the avoidance threshold to that of a 'principal purpose'.

b. By contrast, using a 'sole or dominant purpose' test would be consistent with attacking only arrangements that are 'clearly egregious'.

2.8. The arguments for introducing the new threshold are as follows:

(1) The threshold is currently used in some of Australia's treaties, and is one of the recommended tests for Action 6 of the OECD BEPS Action Plan (which concerns treaty abuse).

(2) We understand that the ATO believe that the lower threshold will make it easier for them to apply the anti-avoidance provision.

2.9. Both arguments have merit. We believe, on balance, that the MAAL should use the existing 'sole or dominant purpose' test. This would confirm the MAAL's intended narrow operation.

3. ATO guidance

3.1. The Explanatory Memorandum acknowledges that much additional ATO guidance is needed to clarify how the measures in the Bill will operate.

3.2. In our view, the following aspects of the MAAL need particular consideration:

(1) The application of the principal purpose test, if it is to be retained.

(2) When activities are undertaken 'directly in connection' with a supply.

(3) When one entity is 'commercially dependent' on another.

(4) What are 'reasonable commercial grounds' for deferring foreign tax.

It is important that the guidance should not simply replace one set of words with others, but should be based on meaningful examples that seek to draw delineations "at the edge".

3.3. Appendix 2 contains a wider list of ten key topics that would benefit from guidance.

3.4. As currently drafted, the new measures will take effect on 1 January 2016. However, the ATO intends to publish its guidance only 'before the end of the year'.[10] As a general comment, we recommend that where (as here) legislation relies heavily on ATO guidance, the draft guidance should form part of the consultation process.

4. Post-implementation review

4.1. It will be important, wherever possible, to align Australia's domestic implementation of the CbC initiatives with the OECD Implementation Guidance so as to maximise the compliance benefits of standardised global reporting and minimise the compliance costs for multinational enterprises.

4.2. In addition, several future events may affect the measures' application. These include:

(1) the government's response to the Board of Taxation's April 2013 'Review of Tax Arrangements Applying to Permanent Establishments'; and

(2) the OECD's 2020 review of the CbC Report package's implementation.

4.3. We recommend providing for a post-implementation review of the measures in the light of these matters.

[10] Paragraph 6.119 of the Explanatory Memorandum.

Appendix 2: Ten key topics to address during ATO consultation

Definition of 'significant global entity'

1 Meaning of 'total annual income' in section 960-565.

Multinational anti-avoidance law

2 The principal purpose test.

3 The meaning of 'directly in connection' with a foreign entity's supply.

4 When one entity is 'commercially dependent' on another.

5 What constitutes 'reasonable commercial grounds' for deferring a foreign tax liability.

6 How the transfer pricing rules in Subdivision 815-C (arm's length principle for permanent establishments) apply to a 'notional' permanent establishment.

7 When and how the ATO will 'adopt a flexible approach to administering the MAAL for companies that are in the process of restructuring but do not have their new arrangements in place on 1 January 2016'.

Country by country reporting

8 What generally exempt classes are proposed, and how to seek a specific exemption.

9 Design and contents of approved form (including guidance regarding inclusions, and the required level of detail).

10 Interaction with existing documentation requirements (such as existing transfer pricing documentation, the International Dealings Schedule, and the proposed Local File).