

# Chapter 1

## Introduction and overview of the bill

1.1 On 16 February 2017, the Senate referred the provisions of the Treasury Laws Amendment (Combating Multinational Tax Avoidance) Bill 2017 and Diverted Profits Tax Bill 2017 (the bills) to the Economics Legislation Committee for inquiry and report by 20 March 2017.<sup>1</sup>

1.2 The purpose of the bills is to introduce a new diverted profits tax from 1 July 2017, increase administrative penalties where significant global entities have breached their tax reporting obligations, and update Australia's transfer pricing law to give effect to the 2015 Organisation for Economic Cooperation and Development (OECD) transfer pricing recommendations.

1.3 The Treasurer explained why these reforms were necessary in his second reading speech:

Increasing digitalisation, globalisation and technological advancements have changed the way in which multinationals do business. While the expansion of the global economy has delivered many benefits to Australian businesses and consumers, it has also created new and innovative ways for multinational companies to avoid Australian tax by shifting their profits from Australia to lower-taxing countries.

We are committed to ensuring that the Australian tax system keeps pace with the modern economy and that everyone doing business in Australia pays the right amount of tax on their Australian profits.

...

This is a bill that sends a clear message to multinationals—if you wish to operate in Australia, this government expects you to pay your tax, the right amount of tax, and prepare to be challenged and have this legislation and these measures enforced if you wish to violate them.<sup>2</sup>

1.4 These bills implement the suite of tax integrity measures announced as part of the 2016-17 Budget on 3 May 2016 to combat multinational tax avoidance.<sup>3</sup> These measures are intended to fix problems in the tax system to sustainably cover the government's responsibilities for the next generation.<sup>4</sup>

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1 *Journals of the Senate No. 30*, 16 February 2017, p. 992.

2 The Hon Scott Morrison (Treasurer), *Second Reading Speech*, Treasury Laws Amendment (Combating Multinational Tax Avoidance) Bill 2017, House of Representatives Hansard, 9 February 2017, p. 5.

3 The Hon Scott Morrison (Treasurer), *Second Reading Speech*, Treasury Laws Amendment (Combating Multinational Tax Avoidance) Bill 2017, House of Representatives Hansard, 9 February 2017, p. 4.

4 *Budget 2016-17: Overview*, 3 May 2016, p. 2.

## Conduct of the inquiry

1.5 The committee advertised the inquiry on its website and wrote to relevant stakeholders and interested parties inviting submissions by 1 March 2017. The committee received 13 submissions, which are listed at Appendix 1.

1.6 The committee did not hold a public hearing for this inquiry.

1.7 The committee thanks all groups and individuals who took the time to make a written submission.

## Overview of the bill

1.8 Combating multinational tax avoidance has been a focus of both the 2015-16 and 2016-17 Budgets.<sup>5</sup> In the 2015-16 Budget, the government introduced a package of three key reforms to combat multinational tax avoidance:

- The Multinational Anti-Avoidance Law (MAAL) seeks to stop multinationals with significant Australian activities booking profits overseas to avoid paying tax in Australia.
- Doubling the penalties for large companies that enter into tax avoidance or profit-shifting schemes.
- Country-by-Country reporting requires large multinationals to report their income and tax paid in every country where they operate to the Australian Taxation Office.<sup>6</sup>

1.9 The 2016-17 Budget continued this process of multinational tax reform by introducing a diverted profits tax, increasing penalties for breaches to tax reporting obligations, and modernising transfer pricing rules in line with best practice at an international level.<sup>7</sup>

### *Diverted profits tax*

1.10 Schedule 1 of the Treasury Laws Amendment (Combating Multinational Tax Avoidance) Bill 2017 seeks to amend the *Income Tax Assessment Act 1936*, the *Taxation Administration Act 1953* and associated acts to introduce a new diverted profits tax (DPT) from 1 July 2017. If the DPT applies, the Diverted Profits Tax Bill 2017 would impose tax on the amount of the diverted profit at the rate of 40 per cent.<sup>8</sup>

1.11 The primary objectives of the DPT are:

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5 The Hon Scott Morrison (Treasurer), *Second Reading Speech*, Treasury Laws Amendment (Combating Multinational Tax Avoidance) Bill 2017, House of Representatives Hansard, 9 February 2017, p. 4.

6 The *Tax Laws Amendment (Combating Multinational Tax Avoidance) Act 2015* was the legislative instrument for enacting the reforms announced in the 2015-16 Budget.

7 The Hon Scott Morrison (Treasurer), *Second Reading Speech*, Treasury Laws Amendment (Combating Multinational Tax Avoidance) Bill 2017, House of Representatives Hansard, 9 February 2017, pp. 5-7.

8 Explanatory Memorandum, p. 7.

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- to ensure that the Australian tax payable by significant global entities properly reflects the economic substance of the activities that those entities carry out in Australia;
  - to prevent those entities from reducing the amount of Australian tax they pay by diverting profits offshore through contrived arrangements between related parties; and
  - to encourage significant global entities to provide sufficient information to the Commissioner of Taxation (the Commissioner) to allow the timely resolution of disputes around Australian tax.<sup>9</sup>

1.12 The DPT targets multinationals entering into arrangements with offshore related parties that lack economic substance, in order to divert their Australian profits to lower tax countries and avoid paying Australian tax.<sup>10</sup>

1.13 The DPT will apply to large multinationals considered to be significant global entities with annual global income of \$1 billion or more with total assessable income, exempt income and non-assessable non-exempt income of more than \$25 million with schemes that involve associated entities that do not have the economic substance to justify their income.<sup>11</sup>

1.14 The DPT would apply to a scheme, in relation to a tax benefit (DPT tax benefit) if, broadly:

- a taxpayer (a relevant taxpayer) has obtained, or would but for section 177F obtain, the DPT tax benefit in connection with the scheme for an income year;
- it would be concluded that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme did so for a principal purpose of, or for more than one principal purpose that includes a purpose of enabling the relevant taxpayer (and possibly another taxpayer) to obtain a tax benefit, or both to obtain a tax benefit and reduce a foreign tax liability;
- the relevant taxpayer is a significant global entity for the income year—that is, a member of a group with annual global income of at least \$1 billion;
- a foreign entity that is an associate of the relevant taxpayer is the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme, or is otherwise connected with the scheme or any part of the scheme;
- the relevant tax payer is not a managed investment trust, a foreign collective investment vehicle with a wide membership, a foreign entity owned by a

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9 Explanatory Memorandum, p. 8.

10 The Hon Scott Morrison (Treasurer), *Second Reading Speech*, Treasury Laws Amendment (Combating Multinational Tax Avoidance) Bill 2017, House of Representatives Hansard, 9 February 2017, p. 5.

11 Explanatory Memorandum, p. 8.

foreign government, a complying superannuation entity, or a foreign pension fund; and

- it is reasonable to conclude that none of the following tests apply to the relevant taxpayer, in relation to the DPT tax benefit:
  - the \$25 million income test—the sum of the assessable income, exempt income and non-assessable non-exempt income of the relevant taxpayer, the assessable income of any other associated entities that are members of the same global group and, if the DPT tax benefit relates to an amount not being included in assessable income, the amount of the DPT tax benefit, does not exceed \$25 million;
  - the sufficient foreign tax test—the increase in the foreign tax liabilities of foreign entities resulting from the scheme is 80 per cent or more of the reduction in the Australian tax liability of the relevant taxpayer; or
  - the sufficient economic substance test—the profit made as a result of the scheme by the relevant taxpayer and by each entity that is an associate of the relevant taxpayer and entered into or carried out the scheme or part of the scheme, or is otherwise connected with the scheme or any part of the scheme, reasonably reflects the economics substance of the entity's activities in connection with the scheme.<sup>12</sup>

1.15 If the DPT applies to a scheme, the Commissioner may issue a DPT assessment to the relevant taxpayer. Under the DPT assessment, tax would be payable on the amount of the diverted profits at a penalty rate of 40 per cent.<sup>13</sup>

1.16 Where the Commissioner makes a DPT assessment, the taxpayer will have 21 days to pay the amount set out in the DPT assessment.<sup>14</sup>

1.17 Following the issue of the notice of a DPT assessment, the taxpayer will be able to provide the Commissioner with further information disclosing reasons why the DPT assessment should be reduced (in part or in full) during the period of review (generally 12 months after notice of the DPT assessment is given).<sup>15</sup>

1.18 If, at the end of that period of review, the relevant taxpayer is dissatisfied with the DPT assessment, or the amended DPT assessment, the taxpayer would have 60 days to challenge the assessment by making an appeal to the Federal Court of Australia. However, the taxpayer would generally be restricted to adducing evidence that was provided to the Commissioner before the end of the period of review.<sup>16</sup>

1.19 The DPT is consistent with the global approach to tax avoidance as it supports the OECD Base Erosion and Profit Shifting (BEPS) transfer pricing reforms by

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12 Explanatory Memorandum, pp. 9-10.

13 Explanatory Memorandum, p. 101.

14 Explanatory Memorandum, p. 10.

15 Explanatory Memorandum, p. 10.

16 Explanatory Memorandum, p. 10.

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encouraging greater cooperation and providing an additional power for the Commissioner to address arrangements that divert profits offshore and lack economic substance.<sup>17</sup>

1.20 The DPT is also consistent with Australia's tax treaties as there is a principle endorsed in the OECD guidance that the benefits of bilateral tax treaties should not be available where there is a tax avoidance purpose. Australia's bilateral tax treaties prevail over Australia's domestic laws aside from the Part IVA anti-avoidance provisions. Therefore, the DPT would not be subject to Australia's bilateral tax treaties as it is an anti-avoidance measure to be inserted into Part IVA of the *Income Tax Assessment Act 1936*.<sup>18</sup>

1.21 As such, the introduction of the DPT is not expected to have a material impact on investment in Australia as it is an integrity measure to ensure the tax paid by significant global entities reflects the economic substance of their activities in Australia. Indeed, it is estimated that as little as 130 taxpayers may need to engage with the ATO on the application of the DPT.<sup>19</sup>

### ***Increasing penalties for significant global entities***

1.22 Schedule 2 of the Treasury Laws Amendment (Combating Multinational Tax Avoidance) Bill 2017 seeks to amend the *Tax Administration Act 1953* to increase the administrative penalties that can be applied by the Commissioner of Taxation to significant global entities to encourage them to better comply with their taxation obligations, including lodging tax documents on time and taking reasonable care when making statements.<sup>20</sup>

1.23 The increased penalties apply to all lodgements required in the approved form, which includes income tax returns, activity statements, Country-by-Country reports and general purpose financial statements. Where an entity is liable for failing to lodge on time (FTL) under this provision, the base penalty amount is multiplied by 500 if the entity is a significant global entity.<sup>21</sup>

1.24 The FTL penalty for a significant global entity would range from 500 units for documents lodged up to 4 weeks late to 2 500 units for documents lodged over 16 weeks late. The FTL penalties for significant global entities would be 100 times larger than for a 'large entity' as outlined in subsection 286-80(4).<sup>22</sup> This means that the bill would:

...raise the maximum administrative penalty for significant global entities who fail to comply with their tax reporting obligations from \$5,250 to

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17 Explanatory Memorandum, p. 105.

18 Explanatory Memorandum, pp. 105-106.

19 Explanatory Memorandum, pp. 104-105.

20 Explanatory Memorandum, p. 71.

21 Explanatory Memorandum, pp. 72-73.

22 Explanatory Memorandum, p. 77.

\$525,000 when taking into account the increase in the value of Commonwealth penalty unit announced in the 2016-17 Mid-Year Economics and Fiscal Outlook.<sup>23</sup>

1.25 The amendments would also double the base penalty amount for penalties relating to statements and failing to give documents necessary to determine tax-related liabilities to the Commissioner on time, if the entity is a significant global entity at the relevant time.<sup>24</sup>

1.26 The table below sets out the new penalty amounts imposed under section 284-75 that would apply to significant global entities.

**Table 1: Base penalty amount applying for significant global entities**

<i>Culpable behaviour</i>	<i>Base penalty amount</i>
<b><i>Statement results in shortfall amount – base penalty amount calculated as % of shortfall</i></b>	
Intentional disregard	150%
Recklessness	100%
No reasonable care	50%
No reasonably arguable position	50%
<b><i>Statement does not result in shortfall amount – base penalty amount in penalty units</i></b>	
Intentional disregard	120 penalty units
Recklessness	80 penalty units
No reasonable care	40 penalty units
<b><i>Document necessary to determine a tax-related liability – base penalty amount calculated as % of tax-related liability concerned</i></b>	
Failure to lodge document on time, where document necessary for Commissioner to determine a tax-related liability accurately	150%

Source: Explanatory Memorandum, p. 79.

1.27 In addition, schedule 2 includes a minor technical amendment to the *Tax Administration Act 1953* that seeks to impose administrative penalties where a significant global entity does not lodge a general purpose financial statement as required under taxation law.<sup>25</sup>

1.28 Specifically, this amendment would enable the Commissioner to impose FTL penalties where an entity, that has not already provided a statement to the Australian Securities and Investments Commission, lodges a statement late or fails to lodge a statement with the Commissioner. This would be achieved by requiring such statements to be provided to the Commissioner in the approved form. Such a

23 The Hon Scott Morrison (Treasurer), *Second Reading Speech*, Treasury Laws Amendment (Combating Multinational Tax Avoidance) Bill 2017, House of Representatives Hansard, 9 February 2017, p. 6.

24 Explanatory Memorandum, p. 78.

25 Explanatory Memorandum, p. 71.

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modification would align the operation of the lodgement obligation with the intent of the original amendments inserting the obligation.<sup>26</sup>

### ***Transfer pricing guidelines***

1.29 Schedule 3 of the Treasury Laws Amendment (Combating Multinational Tax Avoidance) Bill 2017 amends the *Income Tax Assessment Act 1997* to update Australia's transfer pricing rules in Division 815 to include the OECD BEPS amendments to the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrators that were approved by the OECD Council on 23 May 2016.<sup>27</sup>

1.30 The application of the transfer pricing rules in Division 815 is required to be consistent with the new 2015 OECD Report, which is designed to amend and update the 2010 OECD Guidelines to enhance their integrity.<sup>28</sup>

### ***Scrutiny of bills***

1.31 The Standing Committee for the Scrutiny of Bills commented on these bills in the *Scrutiny Digest No. 2 of 2017*. That committee sought an explanation from the Treasurer on two issues:

- why merits review before the Administrative Affairs Tribunal (AAT) is excluded in relation to diverted profits tax assessments and whether the inability to seek review in the AAT may, in any way, change the nature of the substantive outcome or the remedy for a taxpayer who succeeds in proceedings under Part IVC of the *Tax Administration Act 1953* objecting to an assessment; and
- why the amendments are proposed to apply retrospectively to income years starting on or after 1 July 2016 and whether this will cause detriment to any taxpayer.<sup>29</sup>

1.32 The next *Scrutiny Digest* is due to be tabled on 22 March 2017 and interested parties should look to that report to see whether a response has been received from the Treasurer.

### ***Compatibility with human rights***

1.33 All of the schedules in these bills are compatible with human rights and freedoms.

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26 Explanatory Memorandum, p. 80.

27 Explanatory Memorandum, p. 83.

28 Explanatory Memorandum, p. 84.

29 Standing Committee for the Scrutiny of Bills, *Scrutiny Digest No. 2 of 2017*, pp. 39-40.

