Treasury LAws Amendment (2018 Measures No. #) Bill 2018

EXPOSURE DRAFT EXPLANATORY MATERIALS

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Glossary

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

|  |  |
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| Abbreviation | Definition |
| ITAA 1936 | *Income Tax Assessment Act 1936* |
| ITAA 1997 | *Income Tax Assessment Act 1997* |

1. Toughening the multinational anti‑avoidance law

## Outline of chapter

Schedule # to this Bill amends the ITAA 1936 to ensure that the multinational anti-avoidance law applies appropriately to artificial or contrived arrangements involving trusts and partnerships entered into by multinational entities to avoid the taxation of business profits in Australia.

All legislative references in this Chapter are references to the ITAA 1936 unless the contrary is specified.

## Context of amendments

### Operation of existing law

Schedule 2 to the *Tax Laws Amendment (Combating Multinational Tax Avoidance) Act 2015* amended the ITAA 1936 to introduce the multinational anti-avoidance law.

The multinational anti-avoidance law can result in the general anti-avoidance rules under Part IVA of the ITAA 1936 applying to schemes in which:

* a foreign entity that is a ‘significant global entity’ derives income from making supplies to Australian customers;
* with the support of an Australian resident entity or an Australian permanent establishment of an entity that is either associated with or commercially dependent on the foreign entity; and
* some or all of the income is not attributable to a permanent establishment in Australia.

A ‘significant global entity’ is, broadly, an entity that either has annual global income of $1 billion or more or is part of a group of entities that are consolidated for accounting purposes and have annual global income of $1 billion or more.

Consistent with the general framework of Part IVA, for the multinational anti-avoidance law to result in Part IVA applying to a scheme, at least one of the persons involved in entering into or carrying out the scheme must have done so with a principal purpose of obtaining a tax benefit (or both a tax benefit and a reduction in foreign tax liabilities) for a person or persons.

Where a scheme is captured by the multinational anti-avoidance law, the Commissioner of Taxation has the power to make a determination under Part IVA and apply the tax law in such a way as to undo any tax benefit, including, for example, by treating the foreign entity as if it had been making the relevant supplies through an Australian permanent establishment.

The quantum of the tax benefit obtained under the scheme will depend on the facts and circumstances of the case. However, it is likely to include the amount of 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 also takes into account obligations arising (for the relevant taxpayer or another taxpayer) under Australia’s withholding tax rules.

### Budget announcement

In the 2017-18 Budget, the Government announced amendments to the multinational anti-avoidance law as part of a package of measures to improve the integrity of the tax system.

The announced amendments are intended to address concerns that entities can avoid the multinational anti-avoidance law applying to a scheme by interposing a trust or partnership. If the interposed entity makes the supply and receives the income before passing it back to the foreign entity, the multinational anti-avoidance law may not apply to the scheme.

## Summary of new law

* 1. Schedule # amends the ITAA 1936 to provide that, when determining if the multinational anti-avoidance law applies to a scheme, supplies made and income received by a closely related trust or partnership are treated as being made or received by the foreign entity.

Comparison of key features of new law and current law

|  |  |
| --- | --- |
| New law | Current law |
| Special rules apply to determining if a foreign entity satisfies the conditions for the multinational anti-avoidance law to apply if supplies are supplies are made by a trust or partnership. Supplies made by a trust or partnership to Australian customers and income received from these supplies are treated as being made or received by a foreign entity if the trust or partnership has at least one foreign entity participant and:* is connected with the foreign entity; or
* would be an affiliate of the foreign entity if the trust or partnership was an individual or a company; or
* is part of a global group that also includes the foreign entity.
 | The supplies and income of Australian entities controlled by foreign entities are generally not relevant when determining if a foreign entity satisfies the conditions for the multinational anti-avoidance law to apply.  |

## Detailed explanation of new law

* 1. Schedule # amends the ITAA 1936 to extend the circumstances in which the multinational anti-avoidance law in section 177DA results in the general anti-avoidance rules in Part IVA applying to a scheme.
	2. As a result of the amendment, when determining if the conditions for the multinational anti-avoidance law to apply to a scheme in subsection 177DA(1) are satisfied:
* supplies made by a trust or partnership to an Australian customer can be treated as being made by a foreign entity to the customer; and
* income received by a trust or partnership can be treated as being received by a foreign entity.

[Schedule #, item 2, paragraph 177DA((7)(b) and subsection 177DA(8)]

Previously, there were questions about whether the multinational anti-avoidance law would apply if a foreign entity restructured so that is supplies to Australian customers were made through an Australian trust or partnership. This amendment ensures that the application of the multinational anti-avoidance law cannot be avoided by interposing an Australian trust or partnership between the foreign entity and its Australian customers.

### Conditions

In order for this extension to apply, the trust or partnership must:

* have a relationship with a foreign entity that means they are not independent of that entity; and
* have a foreign entity participant.

The trust or partnership must also make at least one supply in a year of income to an Australian customer that results in income for the trust or partnership This condition ensures that the extension only applies if it would be relevant

[Schedule #, item 2, paragraphs 177DA(7)(a) to (d)]

#### Lack of independence

There are various forms of control and mutual dependence that result in a trust or partnership lacking independence.

One such circumstance is that the trust or partnership is ‘connected with’ the foreign entity within the meaning of section 328-125 of the ITAA 1997. Two entities are connected with each other if one entity controls the other or both entities are controlled by a third party. In this context, controlling an entity generally means being entitled to at least 40 per cent of any income distribution, capital distribution or voting rights of the entity. ***[Schedule #, item 2, subparagraph 177DA(7)(a)(i)]***

Another such circumstance is where the trust or partnership would be an affiliate of the foreign entity if the trust or partnership were an individual or a company. This means that the trust or partnership would be expected to act at the direction of or in concert with the foreign entity when carrying on its business. ***[Schedule #, item 2, subparagraph 177DA(7)(a)(ii)]***

* 1. The final circumstance is that the trust or partnership and the foreign entity are both members of a global group within the meaning of Part IVA (ie. a group of entities consolidated for accounting purposes). ***[Schedule #, item 2, subparagraph 177DA(7)(a)(iii)]***

In all of these cases, the trust or partnership and the foreign entity have a sufficiently close relationship that it is reasonable to expect that they may not be acting independently.

#### Foreign entity participant

The second requirement for the extension to apply is that the trust or partnership has a foreign entity participant, which can occur in two circumstances. ***[Schedule #, item 2, paragraph 177DA(7)(d)]***

The first circumstance is a beneficiary of the trust or partner of the partnership is a foreign entity (within the meaning of the ITAA 1997). ***[Schedule #, item 1, paragraph 177DA(1)(a)]***

The second circumstance is a beneficiary of the trust or partner of the partnership has a foreign entity participant. In working out if this circumstance arises, this rule takes into account its own application to other entities. As a result, an entity that has a foreign entity participant as a result of the rule is a foreign entity participant when working out if other entities have a foreign resident participant. ***[Schedule #, item 1, paragraph 177DA(1)(b)]***

For example, if Trust A is a member of Partnership B, which is a member of Trust C, then if Trust A has a foreign entity participant this results in Partnership B and Trust C also having a foreign entity participant.

It should be noted that the foreign entity participant in a trust or partnership does not need to be the same entity as the foreign entity from which the trust or partnership is not independent – they can be entirely separate entities.

Effectively, a trust or partnership has a foreign entity participant if some or all of its income could be distributed offshore and subject to tax in the hands of an entity that is a non-resident.

If an entity has both a foreign entity participant and lacks independence there is a real risk that the trust or partnership can be used to transfer income offshore without being subject to the multinational anti‑avoidance law.

These amendments address this by ensuring that, for the purposes of satisfying the conditions of the multinational anti-avoidance law, the supplies and income of such a trust or partnership are attributable to the closely related foreign entity. ***[Schedule #, item 2, subsection 177DA(8)]***

Even if these amendments result in the supplies and income of a trust or partnership being treated as the supplies and income of a foreign entity under the multinational anti-avoidance law, this does not necessarily mean the general anti-avoidance rules apply. This is because this extension applies only for the purpose of determining if the conditions in subsection 177DA(1) are satisfied. It has no effect on the operation of the taxation law for other purposes, including in the remainder of Part IVA. ***[Schedule #, item 2, subsection 177DA(8)]***

It is still necessary to determine that all of the other conditions are met, including (broadly) that an entity has carried out a scheme for the principal purpose of obtaining a tax benefit.

## Application and transitional provisions

* 1. The amendments made by Schedule # commence on the first day of the first quarter to start following the day this Bill receives Royal Assent.
	2. The amendment made by Schedule # apply from the original application date of the multi-national anti-avoidance law – on or after 1 January 2016 in connection with a scheme, whether or not the scheme was entered into or had begun to be carried out before that day. ***[Item 3, Schedule #]***
	3. This retrospective application is necessary as the measure is an integrity measure designed to ensure that a key anti-avoidance provision operates as intended.
	4. Not making the law retrospective could reward entities that have engaged in deliberate tax avoidance and incentivise further attempts to undermine the Australian tax system.