



Thursday, 30 June 2016

Mr. Brendan McKenna  
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The Treasury  
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## Tax Integrity: Implementing a Diverted Profits Tax

Dear Mr. McKenna,

The American Chamber of Commerce in Australia is writing in response to the request for submissions as set out in the Consultation paper "Implementing a Diverted Profits Tax" issued by the Australian Government Treasury in May 2016 ("**Consultation Paper**").

The American Chamber of Commerce in Australia - better known as AmCham - was founded in 1961 by Australian and American businesses to encourage the two-way flow of trade and investment between Australia and the United States, and to assist its members in furthering business contacts with other nations. In pursuing this goal, AmCham has grown and diversified. It finds itself not only representing the United States' business view, but also speaking increasingly for a broad range of members involved in the Australian business community.

AmCham represents the interest of American companies undertaking business activity in Australia. American investment accounts for 24 per cent of all foreign investment in Australia which makes it, by far, the single largest investor in Australia.

### Diverted Profits Tax ("DPT")

AmCham recognizes that globalisation has profoundly impacted how multinational corporations are organised and the way they conduct business. Multinational companies seek to be competitive in an international market and their investments are likely to be made where profitability is the highest. As profitability is impacted by the taxes paid, it follows that a country's tax system will impact where multinational companies will invest.

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The members of AmCham are aware of, and strongly support, the efforts of the Organisation for Economic Co-operation and Development (“OECD”) and the G-20 in working towards a unified movement of tax reform to ensure that global tax rules remain current with business evolution.

It is against this backdrop that Australia has made a number of unilateral proposals to change its international tax laws, namely the Multinational Anti-Avoidance Law (“MAAL”) which was implemented from 1 January 2016 and now the proposed DPT. Australia is also proposing to implement the OECD’s recommendations on hybrid mismatch rules.

AmCham has previously made submissions on the MAAL and proposed hybrid mismatch rules. As AmCham has noted in its previous submission in respect of the MAAL, the Australian Government’s unilateral actions in advance of the finalisation of the OECD’s tax reform projects presents the risk of other countries undertaking similar unilateral action, which is unlikely to be effective and may have negative consequences, including increased potential for double taxation and may operate as a disincentive to cross-border investment. As the DPT is yet another unilateral measure, similar potential negative consequences may arise as a result of the introduction of the DPT.

AmCham believes that multilateral action is critical for the OECD BEPS project to succeed and that Australia should be consistent with the rest of the world.

AmCham notes that Australia’s tax system is amongst the best and most comprehensive tax systems globally. Amongst other measures, Australia has in recent years tightened its general anti-avoidance rules (“GAAR”), rewritten its transfer pricing rules and tightened debt limitations by reducing its thin capitalization safe harbor threshold. Australia has adopted Country-by-Country Reporting and other measures which significantly increases tax transparency of multinationals. In addition, as part of the 2016-2017 Federal Budget announcements, the Government has proposed to implement the OECD’s recently updated Transfer Pricing Guidelines to ensure that Australia continues to have best practice transfer pricing rules to help prevent multinationals using excessive related party payments to shift profits overseas. In light of these numerous integrity measures and greater tax transparency, AmCham queries the need to further introduce a DPT, which would further increase the compliance burden of multinationals, and which will likely make doing business in Australia more prohibitive.

It is AmCham’s view that the proposed DPT creates significant uncertainty for American multinational investors, both current and future investors. In particular, if the Government proceeds with the DPT despite our concerns, there are a number of features of the proposed DPT which require further clarification and consultation.

#### **1. Effective Mismatch Test**

The effective mismatch test outlined in the Consultation Paper is currently proposed at a rate (80%) which covers many countries including significant trading partners such as the U.K.

For commercial reasons, it is common practice for U.S. multinationals investing into Australia to use holding structures for their Asia Pacific investments through jurisdictions such as Singapore (i.e. jurisdictions which would have an effective tax rate of less than 24%).

Many commercial transactions with common trading partners will *prima facie* meet the effective mismatch test and require consideration of whether the insufficient economic substance test is met. The analysis required is likely to result in increased complexity and additional compliance costs for many taxpayers. AmCham recommends this 'gateway test' be more targeted towards transactions which have the potential to significantly shift profits from Australia to offshore.

## **2. Insufficient Economic Substance**

The Consultation Paper does not provide any detail on how insufficient economic substance will be determined. Given the way the effective tax mismatch test is proposed, we would expect that this test will be the focus of most analysis under the DPT.

It is unclear how non-tax financial benefits will be identified and quantified. Further, it is also unclear how this test will interact with the numerous other specific anti-avoidance measures and the GAAR. Accordingly, this test will likely introduce more uncertainty into the Australian tax law. At a minimum, AmCham recommends that detailed guidance be provided in respect of the circumstances in which insufficient economic substance will arise.

## **3. Application to Financing Arrangements**

Extending the DPT to financing arrangements creates further uncertainty for common transactions for inbound multinational groups. Australia has recently tightened its thin capitalisation rules, and it is generally the case that these rules, along with the debt/equity rules, are designed to govern the deductibility of interest for related party loans. The transfer pricing rules also require interest to be at an arm's length rate. Further, the proposed implementation of anti-hybrid rules provide an additional integrity measure in respect of related party financing arrangements.

We note that the U.K. DPT, which the Australian version is being modelled against, specifically excludes financing arrangements. We understand that this is on the basis that the U.K. is proposing to implement the OECD recommendations in respect of interest limitations, which Australia has already addressed through the changes that have been made to its existing thin capitalisation rules.

AmCham's view is that the existing measures are sufficient to govern the taxation of related party financing arrangements and the application of the DPT to financing arrangements would only increase the complexity and uncertainty on the treatment of financing arrangements for inbound multinational investors.

#### **4. New Administrative Regime**

The new administrative regime proposed appears to be a significant departure from the existing tax administration processes in the Australian tax law. Instead of a self-assessment system, the proposed DPT appears to provide the ATO with broad administrative powers to impose a provisional DPT assessment for matters up to 7 years after lodgment of tax returns.

The requirement for upfront payment of DPT liability appears punitive and onerous. For example, taxpayers may have legitimate differences of opinion from the ATO in respect of their transfer pricing position and under the proposed DPT, such a difference in opinion would be penalised and taxpayers would be put in a position to spend considerable time and resources to negotiate with the ATO in respect of their affairs and have to argue that they have the right tax outcome.

AmCham recommends that the DPT would benefit from having an independent review process to ensure there are appropriate safeguards and checks and balances in place before a provisional DPT liability is imposed on a taxpayer.

#### **5. Potential for Double Taxation**

A taxing mechanism for DPT outside of that which currently applies to income tax would mean that under Australia's various Double Tax Agreements the DPT would not be expected to fall within the scope of 'income tax' for the purposes of 'taxes covered' by Australia's tax treaties. Given the potentially arbitrary nature of transaction reconstructions under the DPT rules, the failure to take account of allowable arm's length payments, the fact that it would be imposed outside of the income tax framework and not creditable against income tax, it is likely that the DPT would not be treated as an income tax by Australia's treaty partners.

#### **Conclusion**

Australia is a capital dependent country and it is important to ensure there are not inadvertent signals sent to foreign investors, including American investors, which would cause potential or actual investors to question the governance and fairness of the Australian market. AmCham is concerned that the focus of these efforts appears to be very much directed towards foreign companies.

AmCham believes that Australia's tax laws are already among the best in the world. Australia has one of the most rigorous transfer pricing regimes, one of the most highly efficient and respected tax administrations, and a (recently strengthened) GAAR that has worked effectively over 30 years and has been copied by many other countries.

AmCham is supportive of reforming Australia's tax system and the global tax system. AmCham believes that these changes should align with the OECD's efforts as part of a global solution otherwise risk double taxation which is a barrier to trade and investment. Accordingly, AmCham believes effective reform of the global tax system will only be achieved if all of the key global economies participate in a cooperative, coordinated and consistent way.

Yours sincerely,

A handwritten signature in blue ink, appearing to read "Niels Marquardt", with a stylized flourish at the end.

**Niels Marquardt**  
Chief Executive Officer