

The Treasury  
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PARKES ACT 2600

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Dear Sir/Madam

## IMPLEMENTING A DIVERTED PROFITS TAX (DPT)

BDO Australia Limited (BDO) welcomes the opportunity to provide comments on the Treasury consultation paper on “Implementing a Diverted Profits Tax (DPT)” (Treasury Paper<sup>1</sup>). BDO acknowledges the desire for Australia to further strengthen the Multinational Anti-Avoidance Law (MAAL) and that the focus of the legislation is on the commerciality and economic substance of related party transactions, thereby being consistent with the BEPS Actions 8 -10 on “aligning transfer pricing outcomes with value creation”.

We raise some concerns and observations in relation to the proposed DPT:

1. Australia has a long history of working co-operatively and in consensus with its other international trading partners in the OECD on international tax and transfer pricing matters. However, the introduction of a DPT represents a second unilateral measure introduced by the Australian Government. Outside of the UK, this action sets Australia apart from all OECD and G20 countries and is not within the spirit of the OECD Base Erosion and Profit Shifting (“BEPS”) project and recommendations made in October 2015.

In particular, the changes go against the values of achieving consensus and reducing disputes. According to the OECD commentary on BEPS:

*“The aim of the measures is to realign taxation with economic substance and value creation, while preventing double taxation. The BEPS package represents the first substantial renovation of the international tax rules in almost a century. This renovation is necessary not only to tackle BEPS, but also to ensure the sustainability of a consensus-based system aimed at eliminating double taxation. As new rules always raise interpretation issues, Action 14 on improving dispute resolution is a key part of the BEPS Project.<sup>1</sup> (emphasis added)”*

2. Given the rules on the Digital Economy covered in BEPS Action 1 are still subject to a global consensus, it could be argued that the MAAL provides a suitable interim measure to tackle perceived tax avoidance in the emerging digital economy. However, the same cannot be said for the proposed DPT.

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<sup>1</sup> <http://www.oecd.org/ctp/beps-frequentlyaskedquestions.htm>

3. Australia's transfer pricing legislation is being updated to specifically incorporate the latest OECD recommendations from Actions 8-10 of BEPS from 1 July 2016. BEPS Actions 8 – 10 on “aligning transfer pricing outcomes with value creation” addresses concerns where the transfer pricing outcomes are not supported by the economic substance of an arrangement. It is unclear what further benefit a new DPT would provide over and above the revised guidelines and may question the confidence the legislator may have in the application of the guidelines under Australia's law.

Additionally, introducing additional and separate legislation creates further complexities for taxpayers and the Australian Taxation Office (“ATO”) to administer.

4. The proposal to introduce an upfront payment on a diverted profits assessment at a penalty tax rate is an inequitable approach to imposing and collecting Australian taxation. Indeed this requirement for the DPT to be paid upfront could be used by the ATO during an audit to exert undue pressure on a taxpayer to capitulate their position. This could be seen as punitive where a taxpayer asserts they have sufficient economic evidence to support their transfer pricing position.
5. It is unclear whether the DPT is to be a separate tax or part of the existing Income Tax legislation [i.e. Income Tax Assessment Act 1997 (ITAA 1997) and/or Income Tax Assessment Act 1936 (ITAA 1936)].

If the DPT is to be included in the existing Income Tax legislation, will it be incorporated within Part IVA of the ITAA 1936? If so, adjustments under Part IVA are not normally relievable under our Double Tax Treaties (DTAs).

If the DPT is a separate tax, would it be considered to be “substantially like” the Income Tax so as to include the DPT within the ambit of Australia's DTAs”

Resolution of these questions is important for taxpayers to know the interaction between the DPT, Income Tax and the DTAs.

6. By way of contrast, transfer pricing adjustments made under the core Australian transfer pricing provisions contained within Subdivision 815-B of ITAA 1997 could be subject to relief under Australia's DATs through the Mutual Agreement Procedure between Competent Authorities. This makes the existing transfer pricing regime more consistent with the objectives of a consensus-based approach to BEPS than the proposed DPT.
7. Existing Australian transfer pricing provisions in section 815-130 of the ITAA 1997 allow the ATO to reconstruct a taxpayer's transfer pricing arrangements and could be applied to reconstruct the three examples of perceived tax avoidance outlined in the Treasury Paper. On this basis, it is difficult to understand why additional DPT measures would be required.
8. By way of comparison, the UK diverted profits regime includes one limited example relating to intellectual property. The Treasury Paper includes examples covering management charges,

financing and intellectual property.

9. The breadth of the new regime means that the DPT could be used quite widely during transfer pricing audits. This adds an extra level of uncertainty for groups operating in Australia. The objective stated is to capture more blatant tax avoidance measures and so we recommend clear guidance be provided concerning the types of arrangements which would or would not be subject to any new provisions.
10. The calculation of the Diverted Profits Amount (DPA) in paragraphs 32 to 34 of the Treasury Paper, indicate that the DPA calculation is quite different for excessive expense items compared to the calculation of the DPA for other cases (e.g. understated income). In the case of excessive expenses the DPA is 30% of the total transaction expense; whereas for other cases the DPA is the ATO's best estimate of the diverted profit amount.

The Treasury Paper does not indicate why the DPA for excessive expenses is based on 30% of the transaction expense. The actual excessive expense amount could be either much greater or smaller than 30% of the transaction expense.

We look forward to the opportunity to discuss our submission with you in further detail. In the interim, if you have any questions please contact Zara Ritchie on 03 9605 8019 .

Yours sincerely



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Lead Transfer Pricing Partner