MINERALS COUNCIL OF AUSTRALIA

SUBMISSION ON DIVERTED PROFITS TAX EXPOSURE DRAFT LEGISLATION

DECEMBER 2016

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EXECUTIVE SUMMARY

Australia's capacity to capture the next wave of mining investment and to secure future export revenues depends critically on ensuring policy frameworks – not least our taxation system – are internationally competitive. Policy settings, particularly the taxation system, are crucial to attracting the investment needed to develop Australia's minerals resources.

Australia's company tax rate has been frozen for 15 years while competitor countries have progressively lowered their rates. Australia's company tax rate is now 5 percentage points above the developed country average and 8 points higher than the Asian average.

Mining tax ratios are at or near longer term highs, while official company tax data shows mining to be among the highest taxed industries in Australia. The minerals industry faced an effective tax rate of 54.3 per cent in 2014-15, the highest burden for nearly a decade, according to new analysis undertaken by Deloitte Access Economics for the Minerals Council of Australia (MCA).[1]

The proposed DPT is a unilateral action that significantly departs from the international tax framework and Australia's commitment to a global co-ordinated response to Base Erosion and Profit Shifting (BEPS). Introducing new tax rules that are ambiguous, complex and poorly targeted, creates significant uncertainty, significantly increases compliance burden and potentially impacts Australia's international trade and investment.

Interaction of the DPT with Australia's transfer pricing rules

The Organisation for Economic Co-operation and Development (OECD) Transfer Pricing Guidelines (TPG), which provide guidance on the application of the 'arm's length principle', must remain the authoritative method to effectively and efficiently allocate the income of multinationals among taxing jurisdictions. The arm's length principle reflects the international consensus on the appropriate allocation of profits between cross-border transactions.

There is concern that the DPT can be used to adopt non-standard transfer pricing positions where the ATO may not necessarily like the outcome of the arm's length principle. Furthermore, if as expected Australia excludes Part IVA from mandatory arbitration (under the OECD Multilateral Instrument, BEPS Action 14), the ATO could use the DPT to both ignore both the arm's length principle and circumvent the possibility of access to mandatory arbitration as a means of resolving a genuine cross border dispute with another tax authority.

This has the potential to result in significant uncertainty, double taxation and adversely impact Australia's international trade and investment.

The DPT must be applied as a measure of last resort to target artificial and contrived arrangements that divert profits from Australia. Where the ATO has sufficient information to pursue matters under Australia's existing tax laws, the DPT should not be able to be applied.

Economic substance

Penal anti-avoidance provisions should not be applied to bona fide commercial transactions. It is vitally important that the economic substance test is relevant and useful to ensure commercial transactions are excluded from the DPT. Restructuring legitimate business transactions is a wholly arbitrary exercise which will result in double-taxation.

[1] Deloitte Access Economics, Minerals industry tax survey 2016, http://www.minerals.org.au/file_upload/files/publications/MCA_2016_Tax_Survey.pdf

‘Economic substance’ is a subjective concept, and whether an arrangement has economic substance will differ from one person to the next. Therefore, clear objective tests should be included having regard to whether there is sufficient economic substance, including:

- Where a cross-border transaction between two related parties is comparable to uncontrolled transactions, the arrangement will be taken to have sufficient economic substance.
- Where the non-tax financial benefits of the arrangement exceed the financial benefit of the tax reduction, the arrangement will be taken to have sufficient economic substance.
- The legislation should make direct reference to the OECD Transfer Pricing Guidelines as an expressed requirement for consideration of economic substance.

We have included a number of recommendations and discussed these and other issues in further detail in the submission.

1. THE PURPOSE OF THE DIVERTED PROFITS TAX (DPT)

In our June 2016 submission on '*Implementing a Diverted Profits Tax',* we requested that the purpose of the DPT be clearly articulated.

Having the DPT implemented into Australia's Part IVA anti-avoidance rules, makes it abundantly clear that from a policy perspective at least, that the DPT is to be only applied to abusive arrangements (and by extension to recalcitrant taxpayers), that are deemed to be artificial and contrived and not apply to bona fide commercial transactions. Indeed, this is consistent with the policy announcement in the *Budget 2016-17*, where it was stated that '[t]he Government will introduce a new tax (Diverted Profits Tax) aimed at multinational corporations that ***artificially*** divert profits from Australia'[2]. (Emphasis added).

The MCA supports well-designed legislation that can clearly articulate and target abusive and mischievous behaviour. Anti-avoidance rules should not be used broadly as they discourage legitimate activity, undermine investment confidence and impose unnecessary compliance costs.

However, the policy intention has not been carried through to the ED or the EM. Unfortunately, the ED is written in very broad terms creating a real risk that the provisions could be applied to ordinary commercial dealings or may be interpreted inconsistently with its intention. A DPT assessment can result in substantial financial hardship and reputational impact, and therefore it is warranted that all efforts be made to ensure that the legislation is interpreted and applied consistent with the stated purpose.

Section 15AA of the Acts Interpretation Act (1901) says that when courts are interpreting an Act of the Federal Parliament they must make use of a construction which would promote the purpose or object underlying the Act, whether that purpose or object is expressly stated or not, in preference to a construction that would not promote that purpose or object.

To assist the Courts interpret the DPT in the manner that best promotes its purpose (and to also ensure the DPT is administered appropriately), we consider it imperative that for the objective of the DPT be incorporated into the Act and further elaborated in the EM to confirm its intention.

Recommended changes

<u>Exposure Draft</u>

Insert before Section 177H (1)

Object of Section

The object of this Section is to ensure that the amount brought to tax in Australia cannot be diluted by abusive circumstances, through artificial and contrived arrangements by transferring profits, assets or risks offshore through related party transactions that lack economic substance and result in a tax benefit or insufficient foreign tax being paid.

[2] Budget 2016-17, Budget Measures, Budget Paper No.2

2. INTERACTION OF THE DPT WITH AUSTRALIA'S TRANSFER PRICING RULES

The MCA supports the Government's announcement in the Budget 2016-17 that it will amend Australia's transfer pricing law to give effect to the 2015 OECD transfer pricing recommendations. As quite rightly outlined in the measure, 'applying these changes to Australia's transfer pricing rules will keep them in line with international best practice so that profits made in Australia are properly taxed in Australia'.[3]

It is imperative that the OECD TPG, which provide guidance on the application of the 'arm's length principle', remains the authoritative method to effectively and efficiently allocate the income of multinationals among taxing jurisdictions. The arm's length principle reflects the international consensus on the appropriate allocation of profits between cross-border transactions. Dilution of the transfer pricing rules and deviation from the arm's length principle has the potential to wreak havoc on Australia's cross-border investment and trade.

There is genuine concern that the way the ED is written, that the DPT can be applied to ordinary cross-border dealings as an alternate transfer pricing provision to Division 815.

Given that the stated intention of the DPT is to be applied as a measure of last resort to target artificial and contrived arrangements to divert profits from Australia, and to taxpayers who do not cooperate with the ATO, it needs to be stated in the legislation to the effect that the DPT cannot be applied where the arrangement can be dealt with by Australia's transfer pricing rules (or other provisions of the tax acts), and the taxpayer is cooperating with the ATO.

Where the ATO has sufficient information to pursue matters under Australia's existing tax laws, the DPT should not be able to be applied. That is, it should be reserved for instances where the ATO is not able to obtain any meaningful information to apply the laws or if the transaction is artificial and contrived.

2.1 Ability to access mutual agreement procedures (MAP) under treaties

A principal purpose for Australia to enter into double tax agreements (DTAs) with its main trading and investment partners is to reduce tax impediments to cross-border trade and investment. The arm's length principle underpins Australia's DTAs dealing with the allocation and taxation of business profits, so that income is taxed only once.

Where there may be a dispute into the allocation and taxation of business profits, Australia's DTAs require tax administrations to resolve the issue by MAP. While not perfect, MAP provides a platform for the relief of double taxation.

As part of the OECD BEPS project, countries have agreed to important changes in their approach to improve dispute resolution. Australia is one of a large group of countries that has committed to adopt and implement mandatory binding MAP arbitration as a way to resolve disputes that otherwise prevent the resolution of cases through the mutual agreement procedure. The MCA strongly supports mandatory binding MAP arbitration as a mechanism to guarantee that treaty-related disputes will be resolved within a specified timeframe and prevent double taxation.

However, as outlined in Treasury's consultation paper on Australia's adoption of the OECD Multilateral Instrument, 'Australia's initial approach is to also enter a reservation to exclude Australia's general anti-avoidance rule from the scope of arbitration…'[4]. If this approach was to be adopted, DPT assessments will not have access to mandatory binding MAP arbitration and this will preclude access to double taxation relief. This could result in a tax rate of up to 53 per cent (23 per cent foreign tax and 30 per cent Australian tax).

[3] Budget 2016-17, Budget Measures, Budget Paper No.2
[4] *Australia's adoption of the BEPS Convention (Multilateral Instrument) Consultation Paper,* December 2016, The Australian Government the Treasury, pg. 31.

There may be good policy rationale for such a reservation to apply to artificial and contrived arrangements, however, as noted throughout this submission the DPT is currently written very broadly and without any actual tax avoidance requirement or regard to OECD TPGs and the arm's length principle.

There is concern that the ATO could adopt non-standard transfer pricing positions and, by relying on the DPT, both ignore both the arm's length principle and circumvent access to mandatory arbitration as a means of resolving a genuine dispute.

We therefore reinforce the need for statutory provisions to prevent the DPT to be applied to matters which can be resolved by applying Australia's transfer pricing rules, where the taxpayer is cooperating with the ATO and the transaction is not artificial or contrived.

2.2 Extrinsic material and non-binding administrative guidance is not sufficient

Adopting the policy to the effect that the DPT cannot be applied where matters can be resolved by Australia's transfer pricing rules in guidance would be helpful. However, allowing extrinsic material to do the legislation's 'heavy lifting' may not be sufficient when it comes to the courts (or even with the ATO's interpretation of the law).

As we highlight in section 3.1, courts do not necessarily take into account the EM and other guidance. A clear example of this is In *Alcan (NT) Alumina Pty Ltd v Commissioner of Territory Revenue (NT),* where the court said:

> [T]he task of statutory construction must begin with a consideration of the text itself. Historical considerations and extrinsic materials cannot be relied on to displace the clear meaning of the text. The language … of legislation is the surest guide to legislative intention.[5]

In *Federal Commissioner of Taxation v Consolidated Media Holdings Ltd,* the court made a similar comment and said that, '[l]egislative history and extrinsic materials cannot displace the meaning of the statutory text.'[6]

We emphasise this because if the meaning of the statute is clear, the court may not have regard to extrinsic materials, and instead rely only on the words contained in the legislation. Therefore, we think it is very important to include in legislation an explicit restriction that the DPT cannot be applied where the arrangement can be dealt with by Australia's transfer pricing rules (or other provisions of the tax acts), and not have this left to guidance and supporting material.

Furthermore, while we support the ATO issuing timely guidance on the application of new laws, it is noted that this guidance is non-binding, subject to different interpretations and can be revised or withdrawn without notice.

Recommended changes:

Section 145-10 When DPT assessments can be made

Insert after **Section 145-10(b)**

"The Commissioner cannot make an assessment of the *DPT liability amount if it is reasonable for the Commissioner to make a determination whether or not a transfer pricing adjustment is to be made under Division 815 in connection with the scheme".

OR

Insert new Section after Section 177H (1) (e) (iii)

(iv) Section 177# (sufficient information test).

and

[5] [2009] 239 CLR 27, 46-7 [47]
[6] [2012] 293 ALR 257, 268-269 [39].

Insert new Section after Section 177L

177# Diverted profits tax – sufficient information test

(1) This section applies in relation to the relevant taxpayer if it is reasonable for the Commissioner to make a determination whether or not a transfer pricing adjustment is to be made under Division 815 in connection with the scheme.

3. ECONOMIC SUBSTANCE

We are disappointed that the proposal in our June submission for a tight gateway was not reflected in the ED or EM. This would have better targeted the DPT at the areas of concern for the Government, minimise compliance costs and impacts on legitimate transactions and improve certainty of the application of the DPT.

The MCA appreciates that the DPT is not designed to apply to arrangements that have sufficient economic substance. We agree that a penal anti-avoidance provision, which will most likely attract double-taxation, should not apply to bona fide commercial transactions with offshore related parties.

As outlined in the OECD TPG, '[r]estructuring of legitimate business transactions would be a wholly arbitrary exercise the inequity of which could be compounded by double taxation created where the other tax administration does not share the same views as to how the transaction should be structured.'[7] A broad DPT application will only create significant uncertainty, a large compliance burden and a potential impact on investment attractiveness of Australia.

It is vitally important that the economic substance test is relevant and useful to ensure commercial transactions are excluded from the DPT. However, the use of subjective and ambiguous terms such as 'reasonably reflects the economic substance' without any legislative reference is very concerning.

3.1 OECD Transfer Pricing Guidelines

As currently worded, the DPT will not apply where the income reasonably reflects the economic substance of the entity's activities. In general, this is usually the key issue surrounding any transfer pricing dispute, where the taxpayer and the ATO disagree on the amount of income that should be attributed to the entity's economic activities.

We note that for the purposes of applying the sufficient economic substance test, the EM suggests that consideration be given to the guidance in the OECD TPG. However, recent case law suggests that a court may not have regard to the EM and other guidance. Indeed, two recent transfer pricing cases which resulted in the introduction of Australia's current transfer pricing rules, *SNF (Australia) Pty Ltd v Commissioner of Taxation*[8] and *Roche Products Pty Ltd v Commissioner of Taxation*[9], the court rejected the submission that the OECD TPG (that at the time were referenced in extrinsic material), were required to be applied.

In order to ensure a court takes into consideration the OECD TPG when assessing economic substance, to the extent that they can be used for this purpose, we consider that the legislation should make direct reference to the guidelines as an expressed requirement for consideration, similar to Subdivision 815.-B

3.2 Objective tests to satisfy economic substance

'Economic substance' is a subjective concept, and whether an arrangement has economic substance will differ from one person to the next. Therefore, clear objective tests should be included that in having regard whether there is sufficient economic substance.

a. Comparable uncontrolled transactions

Where a cross-border transaction between two related parties is comparable to uncontrolled transactions, then the DPT should not apply.

Since the DPT is directed at tax avoidance, comparability should be viewed in the broader sense whether or not the ATO has taken issue with particular aspects that affect comparability, or whether resolution has been achieved of the ordinary transfer pricing issues that arise under Division 815.

[7] *Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10: 2015 Final Reports,* OECD, October 2015, section 1.123.
[8] [2010] FCA 635
[9] [2008] AATA 639

That is, if it there is a reasonably plausible case for comparability and comparable uncontrolled transactions support this, then the DPT should not be apply. This should provide definitive conclusion that there is sufficient economic substance if the transaction in question exists between two unrelated parties.

Of course, the pricing of the arrangement will remain being subject to Australia's transfer pricing rules.

b. Non-tax financial benefits are greater than tax benefits

At paragraph 29 of the May 2016 *Implementing a Diverted Profits Tax* Discussion Paper (DP), it was noted that "where the non-tax financial benefits of the arrangement exceed the financial benefit of the tax reduction, the arrangement will be taken to have sufficient economic substance." However, this has not been reflected in Section 177L, but instead listed as one of the factors to consider whether there was a principal purpose of obtaining a tax benefit (Section 177H(2)(b)).

We recommend that similar to the UK approach, and so it is consistent with the Government's policy intention, that the non-tax financial benefit test should be included in Section 177L, and where this is satisfied, the DPT will not apply.

Although valuing the non-tax financial benefits may in practice be extremely difficult and burdensome, it will provide greater certainty for taxpayers whether an arrangement falls outside the scope of the DPT.

3.3 Economic substance does not apply where there is insufficient information

We note that in paragraph 1.56 of the EM, the 'sufficient economic substance test' is not intended to apply where the Commissioner may not have sufficient information to be satisfied that the relevant entity has sufficient economic substance.

We further note that in order for Section 177L to apply, each entity that is connected with any part of the scheme must satisfy the condition that its income reasonably reflects the economic substance of the entity's activities. These requirements may present an overly onerous evidentiary burden that taxpayers could not overcome. For example, Country A develops and owns all the intellectual property for widgets. Country A enters into an agreement with affiliates in over 100 countries, including Australia, to distribute the widget. In this example, all the affiliates are in some way connected to the scheme and therefore in order to satisfy the economic substance test, the taxpayer must provide to the ATO information (whether requested or not) to the effect that all the entities have sufficient economic substance. This is unreasonable in a practical sense and this section of the EM should be removed.

Recommended changes: To provide the sufficient economic substance test relevance

177L Diverted profits tax—sufficient economic substance test

(1) This section applies in relation to the relevant taxpayer if the income derived, received or made as a result of the scheme by each entity covered by subsection (2) reasonably reflects the economic substance of the entity's activities in connection with the scheme.

(2) This subsection covers an entity if any of the following apply:

(a) the entity entered into or carried out the scheme or any part of the scheme;

(b) the entity is otherwise connected with the scheme or any part of the scheme.

(3) For the purposes of determining the effect of paragraph (1) has in relation to an entity, consideration must be given to the documents covered in Section 815-135 ITAA 1997.

(4) Paragraph (1) will be satisfied where:

(a) the scheme closely resembles a scheme between two entities that are not associates (within the meaning of section 318)

(b) the non-tax financial benefits of the arrangement exceed the financial benefit of the tax reduction.

Recommended change: remove unreasonable evidentiary burden

Preferred option: Delete paragraph 1.56

Alternative option:

1.56 The sufficient economic substance test will apply only if the **Commissioner requests and the** taxpayer provides information **that the taxpayer has in its (or an associates) possession that is directly relevant in determining whether the requirements of Section 177H are satisfied** ~~to satisfy the Commissioner that the activities of the relevant entity have sufficient economic substance in relation to the income derived, received or made by the entity as a result of the scheme~~.

4. A PRINCIPAL PURPOSE – CONSISTENT WITH PART IVA AND TO REMOVE SUBJECTIVITY

It is apparent that a conscious policy decision has been made to 'lower the bar' in regard to the threshold purpose test in Part IVA, from a 'sole and dominant' purpose to a 'principal purpose', consistent with Section 177DA Schemes that limit a taxable presence in Australia (MAAL). Indeed, this is articulated in paragraph 1.32 of the EM.

However, the inclusion of the words "reasonable to conclude" in place of the existing objective test, means that Section 177H, lowers the bar significantly and fundamentally changes the application of the purpose test making it inappropriate and inconsistent with Part IVA.

Comments by Pagone J in Orica Limited v Commissioner of Taxation [2015] FCA 1399, suggests that the use of "reasonable to conclude" within section 284-145 (regarding scheme penalties) fundamentally changes the application of these provisions.

> The use of the words 'it is reasonable to conclude' in s. 284-145(1)(b) is thus not to be seen to impose a test of objective purpose in place of a finding of the actual (subjective) purpose which the relevant person had … but to qualify the factual finding of an actual purpose in an important respect, namely, that it will be sufficient for the subjective purpose to be found as a reasonable inference rather than requiring a higher threshold: it will be sufficient, in other words, to find an actual purpose if it can reasonably be concluded from the evidence.[10]

Including the words 'reasonable to conclude' has a material effect upon the breadth of application of the DPT. Schemes that are not entered into for a principal purpose of obtaining a tax benefit may be subject to the DPT, merely because it is 'reasonable to conclude' they have been.

For example, it may be reasonable to conclude that dealing with a related party entity with a tax rate lower than 24 per cent (particularly if that rate is ultimately reduced to nil because it has losses) was done so for obtaining a tax benefit, regardless whether or not it was actually considered, whether it is actually concluded, or whether that purpose could reasonably be concluded from the evidence. Indeed, it is difficult to envisage a situation where this condition will not be satisfied unless, of course, a taxpayer refuses to transact with countries with tax rates lower than Australia's. We consider this entirely inappropriate.

The use of 'reasonable to conclude' may result in an unsurmountable legal burden of proof for taxpayers to overcome. We consider this entirely inappropriate as a test for anti-avoidance. As stated above, the use of terms 'a principal purpose' already 'lowers the bar' from the dominant purpose threshold and there is no need to inject further uncertainty and subjectivity into the interpretation of the purpose test. We recommend that the use of 'reasonable to conclude' be removed in this instance.

We can only assume that the words 'reasonable to conclude' have been included to overcome a perceived obstacle if sufficient information is not presented. However, the purpose of including this subjective test is not obvious as there is no reference to it in the EM or the ED. If this phrase is to be maintained, we strongly recommend, that this be 'turned off' where there is sufficient information and also an explanation as to its intention – including why it is appropriate for it only to be included in this Section of Part IVA and the perceived issues that the Government are attempting to address.

As a matter of principle, the ATO should exhaust all information request avenues before seeking to apply the DPT provisions. This would include all powers available under the current taxation laws and exchange of information provisions that are contained in Australia's Double Taxation Agreements (DTAs) and Taxation Information Exchange Agreements (TIEAs).

Recommended action: amend Section 177H (1) so that it is consistent with Section 177DA (1) (b)

[10] Orica Ltd v Federal Commissioner of Taxation [2015] FCA 1399 at [36]

Section 177H(1)(a) "it is ~~reasonable to~~ conclude**d** that (having regard to the matters in subsection (2)) 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…"

5. INDEPENDENT DPT PANEL

Given the serious nature of the DPT, potential financial hardship that can result from application and potential for misuse, appropriate arrangements should be made for independent oversight of its operation.

We recommend that before the ATO can issue a DPT assessment, it must satisfy an independent panel of taxation experts that the arrangement is worthy of being subject to the harsh punitive treatment.

This could be based on a similar concept used to administer and apply Part IVA, the General Anti-Avoidance Rules (GAAR) Panel. The GAAR Panel is made up of ATO officers and external experts who consider Part IVA and other general anti-avoidance matters. It ensures that decisions about applying these provisions are objectively based and well-considered. Without such an independent panel, there are no appropriate checks and balances for the ATO to apply the DPT in appropriate circumstances.

Consideration should be given to embed the independent DPT panel into the legislation, as the UK has done with the GAAR Advisory Panel (Finance Act 2013; Schedule 43 – General anti-abuse rule: procedural requirement).

Embedding such a procedural arrangement of the DPT into the legislation will provide assurance of its proper and intended application.

Recommended action

Incorporate in legislation a DPT panel to provide independent oversight on its application.

We have included in Appendix 1 the UK's legislation on the procedural requirements of the General Anti-Abuse Rules that can be used to model something similar for the DPT.

6. SUFFICIENT FOREIGN TAXES

6.1 Interaction of the DPT with CFC and WHT rules

The ED and EM do not mention the interaction of the Australian Controlled Foreign Company (CFC) rules and Australian Withholding Tax (WHT).

There is no mention of interaction in para 1.108 of the draft EM, which lists a range of consequential amendments not yet included in the ED, and which 'include' certain matters, without mention of the crediting of Australian income tax paid through the CFC rules or the crediting of Australian withholding tax.

The DP said:

> **DPT assessment**
>
> 37. In calculating the DPT due and payable, an offset will be allowed for any Australian taxes paid on the diverted profits.
>
> ***37.1. For example, Australian withholding taxes and Australian tax paid on income attributed under the Controlled Foreign Companies regime could be credited.*** (Emphasis added)

We recommend, as contemplated in the DP, that Australian withholding taxes and Australian tax paid on income attributed under the Controlled Foreign Companies regime be credited against any DPT assessment.

Furthermore, consideration should be given to an explicit statement to the effect that when calculating whether DPT has been triggered, the amount of the Australian tax benefit should recognise amounts recognised under the CFC regime and by way of Australian withholding tax.

6.2 Interaction of the DPT with losses

We note that paragraph 26 of the DP said, '[a]ny available losses which may be available to the offshore related party will not be included in the effective tax mismatch calculation. This will ensure that an effective tax mismatch will not arise only because of the availability of losses.' However, this has not been reflected in the ED, or the EM.

While we hope this is an oversight in the current draft, we would strongly recommend that this policy be reflected in the revised ED and EM. It would be an unjust outcome if when dealing with a related cross-border party in a higher taxing jurisdiction than Australia that an effective mismatch could arise, because of business losses that arose in that country due to adverse economic conditions (e.g. a Global Financial Crisis).

We note that the UK's DPT recognises the availability of losses, and view it is important that losses be taken into account when applying the sufficient tax test.

Recommended action:

1. When calculating whether DPT has been triggered, the amount of the Australian tax benefit should recognise amounts recognised under the CFC regime and by way of Australian withholding tax.
2. Australian withholding taxes and Australian tax paid on income attributed under the Controlled Foreign Companies regime be credited against any DPT assessment.
3. Foreign tax losses are able to be taken into consideration when calculating the sufficient tax test.

7. INTERACTION OF THE DPT AND AUSTRALIA'S THIN CAPITALISATION RULES

We note that paragraph 34 of the DP said that '[w]here the debt levels of a significant global entity fall within the thin capitalisation safe harbour, only the pricing of the debt and not the amount of the debt will be taken into account in determining any DPT liability.'

However, this exemption has not been reflected in either ED or EM, and we recommend that in line with the policy, that an exemption for debt levels within the safe harbour will not be taken into account in determining a DPT liability.

Furthermore, as raised in our June 2016 submission, we recommend that the DPT include all three methods (safe harbour, worldwide gearing and arm's length debt test) allowed under Australia's thin capitalisation rules from being excluded from the DPT. Australia's thin capitalisation rules provide three distinct methods (as was designed by policy) of calculating the maximum allowable debt, and have been recently tightened by the Government.[11]

It is entirely unreasonable to exclude two of the three methods for calculating maximum allowable debt from the DPT. Consideration should be given to make the exemption consistent with the UK DPT, and have loan relationships excluded from the DPT.

Recommended action: Carve out permitted debt under Australia's thin capitalisation rules

Insert after Section 177L

Section 177L Diverted profits tax – thin capitalisation

(1) This section applies in relation to the relevant taxpayer if maximum allowable debt for an income year is within the levels allowed under Division 820.

(2) This section does not apply in relation to the pricing of the debt.

[11] Tax And Superannuation Laws Amendment (2014 Measures No. 4) Bill 2014

8. RESTRICTED DPT EVIDENCE

The ED states that restricted DPT evidence is not admissible in evidence in proceedings under Part IVC on appeal to the Federal Court of Australia. Per the ED, restricted DPT evidence means information or documents that the entity had in its custody or review under its control at a time before, during or after the period of review and the Commissioner did not have in his or her custody or control at any time in the period of review.

We strongly believe this will result in perverse outcomes, and is fundamentally unfair.

8.1 The Commissioner does not ask for information or documents

Where the Commissioner simply does not ask for specific documentation/information during the period of review, then the ED restricts this specific documentation/information from being admissible as evidence.

The fact that a cooperative taxpayer may oblige with all information requests in a timely manner but then not be allowed to submit into evidence information that it has on hand, because simply the ATO did not request it, is entirely unreasonable. It is not an obligation of the taxpayer to simply provide every piece of information to the ATO that may be in existence which is remotely linked with an arrangement in case the matter ever goes to court.

8.2 Information that the entity has after the period of review

We understand that the purpose for excluding evidence that an entity may have after the period of review is to broadly prevent information that the Commissioner has requested but is not provided as it is being held offshore by an affiliate (or parent entity). As a general proposition, we agree that special rule to deal with information that is requested during a period of review but refused to be provided because it is held offshore and later used as evidence in court.

However, this type of action would only apply to a small number of recalcitrant taxpayers. The vast majority of taxpayers cooperate and provide information that is asked for that is in existence which is relevant to the review.

It is often that only once matters proceed to litigation that taxpayers incur significant expenditure on opinions from external experts and other evidence. It is often only after either party exchange statements of fact, issues and contentions that they can effectively address or defend the position they have taken. It would be inappropriate to limit the rights of either party to evidence as the case develops and positions are taken. Under the proposed ED, this information would be inadmissible. Perhaps more perverse, if there may be an important court case after the period of review that may assist the taxpayer's appeal, this information would not necessarily be allowed to be used as evidence.

8.3 Section 264A notices and inadmissible evidence

Under Australia's existing taxation laws, Section 264A ITAA 1936 and the Commissioner's manual, '*Our approach to information gathering'* provides that if a taxpayer refuses or fails to give the ATO the information or document requested in an offshore notice, then that information or document (or secondary evidence of the document) is inadmissible in any court or tribunal proceedings disputing the taxpayer's assessment, unless the ATO consents to it.

Therefore, existing laws and ATO guidance already deal with instances where taxpayer's offshore affiliates refuse to provide information requested by the Commissioner from being used in court.

We recommend that the word 'after' be removed, but make it clear that restricted evidence means information that the taxpayer's offshore affiliate may have under its control at a time before or during the period of review. Furthermore we recommend that restricted evidence only apply to information that has been requested by the Commissioner.

Recommended action: Amend the Restricted DPT evidence provision

Section 145-25 Restricted DPT evidence

(2) **Restricted DPT evidence** means information or documents that:

(a) the entity that is the subject of the *DPT assessment ~~(~~or an associate (within the meaning of section 318) of that entity~~)~~, had in its custody or under its control at a time before~~,~~ or during ~~or after~~ the *period of review; and

(b) the Commissioner did not have in his or her custody or under his or her control at any time in the period of review~~.~~; and

(c) the Commissioner requested at any time in the period of review from the entity that is the subject of the *DPT assessment or an associate (within the meaning of section 318) of that entity.

9. KEY TAXPAYER ENGAGEMENTS EXCLUSIONS

The DPT should not apply where the taxpayer has entered into a Key Taxpayer Engagement (KTE) (including Annual Compliance Arrangements (ACAs) and Pre-lodgement Compliance Review (PCR)) with the ATO that sits in the 'Partnering' Client Risk Continuum. The KTE provides a real-time transparent, engagement approach to working co-operatively with the ATO and encouraging 'justified trust' with the ATO. The KTE environment encourages an environment where the taxpayer can raise compliance risks and other technical and administrative matters and resolve issues in a constructive, efficient manner.

We consider that in order to maintain the incentive for taxpayers to enter into a KTE and to pursue the 'Partnering' section of the Client Risk Continuum, where this form of engagement has been undertaken the DPT should not apply For taxpayers to be subject to the DPT and at the same time be participating in a KTE in the 'Partnering' part of the Client Risk Continuum, would be seen as contradictory and call into question the validity of the KTE process with the potential to impact both the ATO and taxpayers.

Recommended action

To incentivise an ongoing open and transparent relationship between taxpayers and the ATO, a provision should be included to exclude the DPT from applying for taxpayers that have entered into a KTE or similar.

10. EXISTING SAFE-HARBOURS

We are disappointed that the DPT does not include any exemptions for transactions that are covered by existing safe-harbours. The DPT will cause a significant increase in compliance burden for taxpayers and low value, low risk transactions should be completely removed from the DPT's scope.

Recommended action: legislate safe-harbours

We reiterate our recommendation from our June 2016 submission:

Transactions that are covered by existing safe-harbours should be excluded from the DPT. These would include the following:

1. Safe-harbours agreed to under an ACA
2. Where a 5 per cent mark-up has been applied for routine low value service arrangements
3. Transactions that are excluded from the transfer pricing local file reporting
4. Transactions not required to be documented under the ATO's transfer pricing safe-harbours.

11. ADMINISTRATIVE GUIDANCE MATERIAL

The MCA strongly supports the commitment outlined in the EM that the ATO will provide draft guidance to taxpayers at the time of introduction of the DPT legislation to Parliament.

Further detailed consultation will be required to minimise the risk of unintended consequences of the DPT. The MCA would appreciate the opportunity to provide input to this process. However the ATO guidance needs to be issued well in advance of the legislation and the EM being finalised to ensure sufficient time for consultation, to ensure the ATO guidance is in line with the legislation and EM and that any unintended consequences or interpretation can be dealt with appropriately.

Recommended action

ATO to issue draft administrative guidance in advance of the introduction of the DPT legislation to Parliament and to allow sufficient time for consultation to ensure the ATO guidance is in line with the final legislation and EM.

12. PAYMENT OF DPT AMOUNT WITHIN 21 DAYS

As highlighted in our June submission, the DPT upfront payment has the potential to create significant financial impact. Therefore, the DPT amount should not be payable until the completion of the review period. Furthermore, the payment of the DPT should follow the concepts already established for other income tax assessments which generally require the taxpayer to pay 50 per cent of the amended assessment and the remainder is deferred until the matter is resolved.

Recommended action:

1. The payment of the DPT will only be payable after the period of review

2. Only 50 per cent of the DPT assessment will be paid up front.

13. AMENDMENT PERIOD

As outlined in our June Submission, given the DPT is designed with the intention to speed up resolutions of disputes, it is inappropriate that there is a 7 year amendment period.

In this respect, we further note that in *Tax Laws Amendment (Improvements to Self Assessment) Bill (No.2) 2005*, the period for review and amendment of assessments where the general anti-avoidance provision (Part IVA) applies from was reduced from six years to four years.

As there is no basis for this change of policy, the amendment period should be aligned with the standard period for Part IVA amendment of assessments.

Recommended action: aligning the amendment period

Section 145-10(b) ending on the last day of the period of ~~7~~ **4** years starting the day after that day.

14. COMMENCEMENT DATE

There appears to be inconsistency in the proposed commencement date. At paragraph 1.109, the EM states that '[t]he DPT will apply in respect to income years commencing on or after 1 July 2017 in connection with a scheme, whether or not the scheme was entered into, or was commenced to be carried out, before that day.

However, the ED outlines that the DPT will apply "[t]he first 1 January, 1 April, 1 July or 1 October to occur after the day this Act receives the Royal Assent'.

We consider that the commencement date outlined in the ED is simply an error, as it would be completely unreasonable for the DPT to apply to all taxpayers commencing from a certain date even though it may be part way through an income year.

Recommended action: Change commencement date in the ED

~~The first 1 January, 1 April, 1 July or 1 October to occur after the day this Act receives the Royal Assent~~ **Income years commencing on or after 1 July 2017.**

15. APPENDIX 1: UK FINANCE ACT 2013: SCHEDULE 43 – GENERAL ANTI-ABUSE RULE: PROCEDURAL REQUIREMENTS

Carbon price support rate commodity	*Carbon price support rate*
Any gas in a gaseous state that is of a kind supplied by a gas utility	£0.00334 per kilowatt hour
Any petroleum gas, or other gaseous hydrocarbon, in a liquid state	£0.05307 per kilogram
Any commodity falling within paragraph 3(1)(d) to (f)	£1.62534 per gigajoule"

(2) The amendment made by this paragraph has effect in relation to supplies treated as taking place on or after 1 April 2015.

SCHEDULE 43 Section 209

GENERAL ANTI-ABUSE RULE: PROCEDURAL REQUIREMENTS

The GAAR Advisory Panel

1 (1) In this Part "the GAAR Advisory Panel" means the panel of persons established by the Commissioners for the purposes of the general anti-abuse rule.

(2) In this Schedule "the Chair" means any member of the GAAR Advisory Panel appointed by the Commissioners to chair it.

Meaning of "designated HMRC officer"

2 In this Schedule a "designated HMRC officer" means an officer of Revenue and Customs who has been designated by the Commissioners for the purposes of the general anti-abuse rule.

Notice to taxpayer of proposed counteraction of tax advantage

3 (1) If a designated HMRC officer considers—

(a) that a tax advantage has arisen to a person ("the taxpayer") from tax arrangements that are abusive, and

(b) that the advantage ought to be counteracted under section 209,

the officer must give the taxpayer a written notice to that effect.

(2) The notice must—

(a) specify the arrangements and the tax advantage,

(b) explain why the officer considers that a tax advantage has arisen to the taxpayer from tax arrangements that are abusive,
(c) set out the counteraction that the officer considers ought to be taken,
(d) inform the taxpayer of the period under paragraph 4 for making representations, and
(e) explain the effect of paragraphs 5 and 6.

(3) The notice may set out steps that the taxpayer may take to avoid the proposed counteraction.

4 (1) If a notice is given to the taxpayer under paragraph 3, the taxpayer has 45 days beginning with the day on which the notice is given to send written representations in response to the notice to the designated HMRC officer.

(2) The designated officer may, on a written request made by the taxpayer, extend the period during which representations may be made.

Referral to GAAR Advisory Panel

5 If no representations are made in accordance with paragraph 4, a designated HMRC officer must refer the matter to the GAAR Advisory Panel.

6 (1) If representations are made in accordance with paragraph 4, a designated HMRC officer must consider them.

(2) If, after considering them, the designated HMRC officer considers that the tax advantage ought to be counteracted under section 209, the officer must refer the matter to the GAAR Advisory Panel.

7 If the matter is referred to the GAAR Advisory Panel, the designated HMRC officer must at the same time provide it with—
(a) a copy of the notice given to the taxpayer under paragraph 3,
(b) a copy of any representations made in accordance with paragraph 4 and any comments that the officer has on those representations, and
(c) a copy of the notice given to the taxpayer under paragraph 8.

8 If the matter is referred to the GAAR Advisory Panel, the designated HMRC officer must at the same time give the taxpayer a notice which—
(a) specifies that the matter is being referred,
(b) is accompanied by a copy of any comments provided to the GAAR Advisory Panel under paragraph 7(b), and
(c) informs the taxpayer of the period under paragraph 9 for making representations, and of the requirement under that paragraph to send any representations to the officer.

9 (1) The taxpayer has 21 days beginning with the day on which a notice is given under paragraph 8 to send the GAAR Advisory Panel written representations about—
(a) the notice given to the taxpayer under paragraph 3, or
(b) any comments provided under paragraph 7(b).

(2) The GAAR Advisory Panel may, on a written request made by the taxpayer, extend the period during which representations may be made.

(3) The taxpayer must send a copy of any representations to the designated HMRC officer at the same time as the representations are sent to the GAAR Advisory Panel.

(4) If no representations were made in accordance with paragraph 4, the designated HMRC officer—

(a) may provide the GAAR Advisory Panel with comments on any representations made under this paragraph, and

(b) if comments are provided, must at the same time send a copy of them to the taxpayer.

Decision of GAAR Advisory Panel and opinion notices

10 (1) If the matter is referred to the GAAR Advisory Panel, the Chair must arrange for a sub-panel consisting of 3 members of the GAAR Advisory Panel (one of whom may be the Chair) to consider it.

(2) The sub-panel may invite the taxpayer or the designated HMRC officer (or both) to supply the sub-panel with further information within a period specified in the invitation.

(3) Invitations must explain the effect of sub-paragraph (4) or (5) (as appropriate).

(4) If the taxpayer supplies information to the sub-panel under this paragraph, the taxpayer must at the same time send a copy of the information to the designated HMRC officer.

(5) If the designated HMRC officer supplies information to the sub-panel under this paragraph, the officer must at the same time send a copy of the information to the taxpayer.

11 (1) Where the matter is referred to the GAAR Advisory Panel, the sub-panel must produce—

(a) one opinion notice stating the joint opinion of all the members of the sub-panel, or

(b) two or three opinion notices which taken together state the opinions of all the members.

(2) The sub-panel must give a copy of the opinion notice or notices to—

(a) the designated HMRC officer, and

(b) the taxpayer.

(3) An opinion notice is a notice which states that in the opinion of the members of the sub-panel, or one or more of those members—

(a) the entering into and carrying out of the tax arrangements is a reasonable course of action in relation to the relevant tax provisions—

(i) having regard to all the circumstances (including the matters mentioned in subsections (2)(a) to (c) and (3) of section 207), and

(ii) taking account of subsections (4) to (6) of that section, or

(b) the entering into or carrying out of the tax arrangements is not a reasonable course of action in relation to the relevant tax provisions having regard to those circumstances and taking account of those subsections, or

(c) it is not possible, on the information available, to reach a view on that matter,

and the reasons for that opinion.

(4) For the purposes of the giving of an opinion under this paragraph, the arrangements are to be assumed to be tax arrangements.

(5) In this Part, a reference to any opinion of the GAAR Advisory Panel about any tax arrangements is a reference to the contents of any opinion notice about the arrangements.

Notice of final decision after considering opinion of GAAR Advisory Panel

12 (1) A designated HMRC officer who has received a notice or notices under paragraph 11 must, having considered any opinion of the GAAR Advisory Panel about the tax arrangements, give the taxpayer a written notice setting out whether the tax advantage arising from the arrangements is to be counteracted under the general anti-abuse rule.

(2) If the notice states that a tax advantage is to be counteracted, it must also set out—

(a) the adjustments required to give effect to the counteraction, and

(b) if relevant, any steps that the taxpayer is required to take to give effect to it.

Notices may be given on assumption that tax advantage does arise

13 (1) A designated HMRC officer may give a notice, or do anything else, under this Schedule where the officer considers that a tax advantage might have arisen to the taxpayer.

(2) Accordingly, any notice given by a designated HMRC officer under this Schedule may be expressed to be given on the assumption that the tax advantage does arise (without agreeing that it does).

SCHEDULE 44

Section 216

TRUSTS WITH VULNERABLE BENEFICIARY

Inheritance Tax Act 1984

1 IHTA 1984 is amended as follows.

2 (1) Section 71A (trusts for bereaved minors) is amended as follows.

(2) For subsection (3)(c)(ii) substitute—

"(ii) if any of the income arising from any of the settled property is applied for the benefit of a beneficiary, it is applied for the benefit of the bereaved minor."

(3) In subsection (4), before paragraph (a) insert—

"(za) the trustees' having powers that enable them to apply otherwise than for the benefit of the bereaved minor amounts (whether consisting of income or capital, or both) not exceeding the annual limit,".