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Attention: Greg Wood

Toughening the Multinational Anti Avoidance Law

Deloitte welcomes the opportunity to respond to the "Public consultation on draft legislation to toughen the Multinational Anti-Avoidance Law", as contained in the Exposure Draft entitled *Treasury Laws Amendment (Measures for a later sitting) Bill 2018: MAAL*, which was released by the government on 12 February 2018.

Introduction

By way of background, we note that:

- Paragraph 1.11 of the draft Explanatory Memorandum identifies the arrangement of concern to involve an interposed trust or partnership and in particular, "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".
- "If an entity has both a foreign entity participant and lacks independence there is a real risk that the trust or partnership to transfer income offshore without being subject to the multinational anti-avoidance law" (EM paragraph 1.29).
- "It is still necessary to determine that all of the other conditions are met …" (EM paragraph 1.32). This will include the condition that MAAL only applies with respect to a significant global entity.

As drafted, there are effectively 2 sets of conditions to be satisfied in subsection (7):

- **the supply and income test** in paragraph (7)(b) and paragraph (7)(c) which focus on the interposed entity: that the interposed entity makes a supply resulting in an amount of assessable income
- **the foreign entity test** in paragraph (7)(a) and paragraph (7)(d) which focus on **one or more** foreign entities:
    - the test in paragraph (7)(a) casts a broad net to identify a relationship between the interposed entity and one or more foreign entities (for the sake of simplicity, paragraph (7)(a) is referred to as the **dependence test**)

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- the test in paragraph (7)(d) tests whether the income (referred to in paragraph (7)(c)) accrues to a **foreign entity participant**. The EM makes it clear that the paragraph (7)(a) foreign entity can be an entirely separate entity to the paragraph (7)(d) foreign entity (refer EM para 1.27).

It is unlikely that the foreign entity participant would be "entirely separate" from the identified foreign entity, but we acknowledge that the proposed legislative tests operate in such an "entirely separate" situation.

Submission

Supply and income test: year of income

It is noted in the general provisions of the MAAL at Section 177DA(1), sub-paragraph (a) refers to the making of a supply by the foreign entity and sub-paragraph (d) refers to the foreign entity deriving an amount of income. There is no reference to a year of income in those tests.

In proposed new Section 177DA(7), a year of income is first referenced in sub-paragraph (7)(b)(i): which refers to a year of income in which a supply is made. The test in paragraph (7)(c) then tests whether the supply in a year of income results in an amount of income for **that** year of income. Treasury should consider whether this framework is consistent with the general framework in Section 177DA(1).

Dependence test: timing

The dependence test does not identify a time when the relevant test must be satisfied. We submit that paragraph (7)(a) should be drafted such that it must be the case that the relevant dependence exists in the relevant year of income in which the supply is made.

Foreign entity test

We have a number of comments in respect of the structure of paragraph (a) and paragraph (d):

- The test in paragraph (a) will in most cases identify multiple foreign entities. A particular foreign entity may fall within each of the 3 tests in (i), (ii) and (iii), or it may be the case that a particular foreign entity falls in only one or perhaps 2 of these categories. But in any event, multiple foreign entities will often be identified.
- Paragraph (8)(a) refers to "**the** foreign entity mentioned in paragraph (7)(a)", and so appears to require a **specific** foreign entity to be identified. On one view, it may be that paragraph (8)(a) is effective: provided that there is at least one foreign entity identified in paragraph (7)(a), then it may be the case that one or other of those foreign entities will be capable of being **the** foreign entity for the purposes of paragraph (8)(a).
- However, **the** paragraph (8)(a) foreign entity also needs to be tested to ascertain whether it is a significant global entity (SGE): refer section 177DA(1)(c). Again it may be possible to interpret the provision on the basis that so long at least one foreign entity identified in paragraph (7)(a) is a SGE, the provision can function.

In addition to these potential mechanical issues, it is submitted that the structure may produce inappropriate outcomes:

• Assume a foreign entity is identified via the paragraph (7)(a) dependence test (referred to in this submission as the **identified foreign entity**) • Subject to our comments above, the identified foreign entity would be deemed to via paragraph (8)(a) to have made the supply (activating sub-paragraph 177DA(1)(a)(i)) • Assume a foreign entity "entirely separate" from the identified foreign entity is a **foreign entity participant** (ie, the foreign entity participant is not an entity within any of the tests in paragraph (7)(a)).
As a result, the conditions of paragraph (7) are met and the deeming of paragraph (8) is activated.

It is then necessary to test the conditions in Sub-section 177DA(1) including the SGE test in paragraph 177DA(1)(c).

Under existing Sub-section 177DA(1), the SGE test is applied to the foreign entity referred to in sub-paragraph 177DA(1)(a)(i). Based on the deeming in paragraph (8)(a), the identified foreign entity is taken to have made the supply, and hence, the foreign entity referred to in sub-paragraph 177DA(1)(a)(i) is the identified foreign entity.

The **SGE testing** is thus applied to the **identified foreign entity**.

Consider the following outcomes

	SGE status of		
	Identified foreign entity	**Foreign entity participant**	**Sub-section 177DA(1) satisfied**
1	SGE	SGE	YES
2	Not SGE	SGE	NO
3	SGE	Not SGE	YES
4	Not SGE	Not SGE	NO

It is submitted that the outcomes in scenario 2 and 3 are inappropriate:

- Under scenario 2, the relevant income is derived by a SGE / foreign entity participant. This would suggest that the MAAL could have operation, however, as the identified foreign entity is not a SGE, the MAAL is not activated
- Conversely, under scenario 3, the MAAL could have operation notwithstanding that the foreign entity participant is not a SGE

It is submitted that the scope of the MAAL should always be limited to cases where the person deriving the relevant income (which in the case of an interposed entity scenario is the foreign entity participant) is a SGE.

An **alternative** way to structure these conditions would be to:

1. first, identify the foreign entity participant
2. next, test if the foreign entity participant is a SGE
    a. If no, do not proceed
    b. if yes, undertake the dependence test in respect of the foreign entity participant and members of the foreign entity participant's SGE group. That is, test if the interposed entity is relevantly connected with, affiliated to or a member of a global group with
        i. the foreign entity participant or
        ii. a member of the SGE group of which the foreign entity is a member

177DA(8): consequences of activating 177DA(8):

If the conditions in subsection (7) are met, then subsection (8) deems a number of consequences, that are then relevant to the "normal" MAAL testing in Section 177DA(1).

- Paragraph (8)(b) operates to "treat the Australian customer as being an Australian customer of the particular foreign entity". The mention of Australian customer (where first appearing) assumes that it is possible to identify such an Australian customer in the actual arrangement. However, as is evident in sub-paragraph (7)(b)(ii), prior to the hypothesis in that sub-paragraph, there is no Australian customer, as the supply is not being made by a foreign entity. We read the definition of

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Australian customer to only have relevance in the context of a supply by a foreign entity. That hypothesis does **not** deem the person to which the supply is made to be an Australian customer: it just provides a mechanism to test for the purposes of paragraph (7)(b) whether the person to which the supply is made would be an Australian customer **if** certain assumptions were made.

- Treasury could consider whether the deeming in paragraph (8)(b) should be along the lines of:
    - treat the entity mentioned in paragraph (7)(b) as being an Australian customer of the foreign entity
- We note that proposed paragraph 177DA(8) treats the identified foreign entity mentioned in paragraph (7)(a) as having made the supply (refer paragraph (8)(a)) and to have derived **the** income from the supply (refer paragraph (8)(c)). This appears to be a reference to the entire supply in sub-paragraph s177DA(7)(b)(i) by the interposed entity, and the entire income derived by the interposed entity in paragraph s177DA(7)(c). There could be situations where an identified foreign entity has a, say, 60% interest in the partnership or trust (say directly or via an affiliated foreign entity participant) and an Australian entity is the other 40% partner. Whilst subsection (8) is not the main operative provision (subsection (1) essentially is) subsection (8) seeks to deem certain things for the purposes of subsection (1). It should be clarified that any potential application of the MAAL and the identification of any tax benefit should be determined by reference to the actual arrangement, and not by reference to any deeming under subsection (8). That is, the tax benefit if any in this case, is to be determined by reference to foreign entity participant's actual allocation of income (60% in the scenario) rather than the 100% deemed in subsection (8). This could be clarified in the EM.

We would be pleased to discuss further, and we can be contacted on the numbers below.

Yours sincerely

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