A Bill to expand the operation of Part IVA and to increase administrative penalties has been introduced into Parliament. It contains some important departures from the way that Part IVA has traditionally operated which are relevant not only for this Bill but also as indicators of the future path of Part IVA. The Bill also differs in several important respects from the Exposure Draft released in May. This Tax Brief outlines the key features.

Background

In the May 2015 Budget, the Treasurer announced, ‘a new Multinational Anti-Avoidance Law, that will stop multinationals using complex schemes to escape paying tax. Under this new law, when we catch companies cheating, they will have to pay back double what they owe, plus interest’. An Exposure Draft of the so-called ‘Google tax’ was released at the same time. The Bill to give effect to these announcements was introduced into Parliament on 16 September. It differs from the Exposure Draft in several ways, and the changes both narrow and broaden the scope of the Bill at different points.

The measure, along with the UK’s Diverted Profits Tax which it resembles, have both been publicly criticised by a US Treasury official as taking international tax in a ‘disturbing direction’. The Explanatory Memorandum (EM) to the Bill tries subtly to connect the measure to the OECD’s Base Erosion project, though it certainly pre-empts and may contradict conclusions the OECD will be publishing on 5 October. Nevertheless, the measure will proceed as evidence of the government’s seriousness about curbing international avoidance.

Part IVA amendments

Pre-conditions

In general terms, the measure in the Bill will trigger Part IVA when 5 key tests are met:

- a foreign entity that is part of a global group with annual world-wide income exceeding AUD 1bn makes a supply to an Australian customer (which is not also a member of the group) and derives income or gain from making the supply;
- activities are undertaken in Australia ‘directly in connection’ with that supply by an Australian resident or the Australian branch of a foreign entity;
- the Australian entity or the Australian branch doing those activities is either an associate of the foreign entity making the supply or is ‘commercially dependent’ on the foreign entity;
• some or all of the income or gain the foreign supplier earns from supplies to Australian customers is not attributable to an Australian PE of the foreign supplier; and

• having regard to a number of factors, the person who executed the scheme did so to enable a taxpayer to obtain an Australian tax benefit and the taxpayer does obtain an Australian tax benefit.

The preconditions thus seem to be directed at attacking 2 separate problems:

• PE avoidance: the foreign entity is able to have substantial penetration into the Australian market through activities done by others, but its own activities don’t reach the level of being a PE; and / or

• transfer pricing: the foreign entity does have a PE here but an insufficient proportion of its global profits are being attributed to the Australian PE.

Several key terms and concepts which appear in the Bill are defined or expanded. For example:

• detailed provisions are proposed in order to decide the extent of the global group and to calculate whether the global group has ‘annual global income’ exceeding AUD 1bn. For the most part, the Bill defines these terms by referring to the most recent consolidated financial accounts; and

• the relevant kinds of ‘supplies’ being made by the foreign entity are defined by referring to the concept of ‘supply’ used in the GST legislation, but, in an important change from the Exposure Draft, supplies of equity or debt interests in any entity are excluded (which is intended to exclude private equity funds and similar operations from the new regime).

Playing with the ‘purpose’ standard

The current law says Part IVA is triggered where securing the tax benefit was the actor’s sole purpose, or ‘the dominant purpose’ if there were several objectives in mind.

The new Bill deliberately lowers that standard; the EM notes that, ‘the multinational anti-avoidance law will involve a lower threshold test …’. Instead, it will be sufficient to trigger this measure if securing the tax benefit was ‘one … of the principal purposes …’. This is justified on the basis that it is similar to one of the new treaty abuse standards introduced by the BEPS project in 2014.

In other words, it will now be sufficient if avoiding tax was important; it is no longer necessary to find that avoiding tax was the most important consideration.

Avoiding (or deferring) foreign tax

A second design innovation in the new Bill is the way that saving foreign tax now influences Australian law. The drafting says that Part IVA will now be enlivened if the principal purpose of the relevant scheme was to achieve an Australian tax benefit, or if the purpose was to achieve both the Australian tax benefit and to save or defer foreign tax. This provision is intended to head-off a defence to the operation of this provision which argues that the scheme was primarily directed to saving large amounts of foreign which, and because the amount of Australian tax is so trivial, it could not be said that the scheme had a primary purpose of saving Australian tax.

Accurately understanding the operation of foreign tax laws in real time is not a trivial task for the ATO. Fortunately for the ATO, the Bill takes the position that the ATO doesn’t actually have to understand the foreign law, nor get it right. A special provision says the ATO is to take the effect under foreign law into account, ‘only so far as information relevant to that matter is available to the Commissioner …’. This suggests the ATO can ignore the effects under foreign law if it wants to.

However, the drafting goes on to say that the ATO ‘is not required to acquire further information in order to have regard to that matter …’ which casts the matter in a slightly different light. It suggests that ATO can take foreign law into account if it wants to, but it doesn’t need to bother inquiring about just what the law is! It can just rely on its own views and knowledge.
Consequences

One of the unanswered issues this measure raises is, just what happens once the preconditions are met?

No special rules are proposed in the Bill which means that the existing Part IVA rules would apply. Under the existing rules, a taxpayer who derived a tax benefit struck down by this measure would be assessed on either ‘the events or circumstances that actually happened … other than those that form part of the scheme,’ or on a ‘reasonable alternative’ to the scheme. The Explanatory Memorandum goes to some lengths to explain just how those concepts would be expected to operate.

The EM suggests the relevant taxpayer will likely be assessed on the basis that ‘the supplies [are] made through an Australian permanent establishment of the foreign entity’ which undertakes ‘all of the activities of the Australian-based entity’ and ‘the functions, assets and risks of the foreign entity associated with formally concluding the contracts …’. In short, the foreign entity with no PE in Australia will be deemed to have a PE, and that PE will earn (i) the profit currently earned by the Australian entity doing the relevant activities and (ii) some of the profit currently being booked offshore.

Deeming the foreign supplier to have a PE will trigger a (greater) liability to Australian corporate tax. The EM then goes on to say that this deeming can also trigger a liability to Australian withholding tax, and for taxpayers who are very remote from Australia and have no direct knowledge of the arrangement put in place by the foreign supplier. According to the EM, imputing a PE to the foreign entity allows the ATO to impute interest and royalty expenses to that PE, and since those amounts are now attributable to an Australian PE, when they are paid, the recipients will now have a liability to Australian withholding tax (subject to any relevant treaty limits where the recipient is a resident of a treaty country).

Increased penalties

A second part to the Bill gives effect to the announcement that administrative penalties for global groups will be doubled.

Under the Bill, where a taxpayer that is part of a global group with annual world-wide turnover exceeding AUD 1bn, has undertaken a scheme that is struck down under Part IVA, ‘the amount of the penalty is twice the amount …’ that would apply to another taxpayer lacking a reasonably arguable position and in the same circumstances.

It is important to note that the doubled penalties will apply to any kind of (unsuccessful) tax avoidance scheme, not just the kinds of schemes targeted by the ‘Google tax’ amendments described above, and whether or not the party being penalised is resident or non-resident.

Commencement

The expansion of Part IVA by the ‘Google tax’ measure applies to tax benefits enjoyed from 1 January 2016 regardless of the date on which the scheme which generated the benefit commenced.

The doubling of penalties applies to any scheme benefits which arise in income years starting on or after 1 July 2015.
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G&HSF document ID 510641190

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