Wednesday, 21 December 2016

Manager
Base Erosion and Profit Shifting Unit
Corporate and International Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

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Diverted Profits Tax Exposure Draft

Dear Sir/Madam,

The American Chamber of Commerce in Australia is writing in response to the request by the Treasury for submissions on 29 November 2016, with respect to the exposure draft Bill and associated explanatory material which seeks to strengthen the anti-avoidance rules in Part IVA of the Income Tax Assessment Act 1936 and amend the Tax Administration Act 1953 and associated Acts to give effect to the decision.

As background on us, the American Chamber of Commerce in Australia – more informally 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 business views of American companies here, but also speaking increasingly for a broad range of members across the Australian business community.

That said, AmCham still is the clearest single voice speaking on behalf of American companies undertaking business activity in Australia. American investment accounts for some 27 per cent of all foreign investment in Australia, making it – by far - the single largest foreign investor in Australia. We have over 600 corporate members, many of them subsidiaries of large American multinationals that have invested heavily in Australia over a long period of time. That is the primary perspective that we bring to this particular inquiry.

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Multinational investment decisions will favor countries where there is a competitive, transparent and consistent approach to company taxation. Especially from the perspective of a country like Australia which depends so heavily on foreign capital inflows for its prosperity. We do not believe that the draft Diverted Profits Tax (DPT) legislation helps on these measures.

We believe that some significant, additional fine-tuning of the administrative arrangements is required, and that proposed future arrangements should be submitted again for stakeholder evaluation and commentary before they are formally adopted and applied.

As an initial overarching point, we believe that the Australian Taxation Office (ATO) already has at its disposal entirely adequate tools, capabilities, and laws for achieving the stated objectives of the DPT. That said, we also recognize the political reality that additional new legislation will be forthcoming, so our focus going forward is on ensuring a manageable, predictable, and fair set of new regulations without the unintended result of making Australia uncompetitive in the global game of attracting foreign capital and investment.

In response to the request for submissions, we offer the following thoughts and suggestions:

- The requirement to make a full and immediate payment of what could potentially be a large DPT liability may have significant cash, financial and commercial consequences for a taxpayer (for example liquidity issues and breach of debt covenants). As a result of both this policy decision and the potentially significant consequences for a taxpayer, we consider it critically important that the DPT law itself clearly set out the circumstances in which the DPT should be applied and the operation of all exclusions. Reliance should not be placed on the Explanatory Memorandum to do this and it should not be left to the ATO to decide by guidance such key aspects of the law.

- There is also a lack of specificity around how the dollar value of the DPT assessment will be calculated, and no requirement for the ATO to compensate companies at commercial interest rates where the ATO has seized money using the DPT and the taxpayer has been found to be in the right at the end of the assessment process.

- Our members are concerned that the ATO is likely to use the DPT, if/when enacted, to move from a transfer pricing audit, as this would put the onus on the taxpayer to make their case. Moreover, it seems that the ATO would be able to apply the DPT with very limited information.

Then there is only a 12-month review period for the tax payer to convince the ATO of its position, and only after this period may it be appealed to the Federal court.

- To offset the curtailing of taxpayer's rights and increased ability by the ATO to put economic pressure on companies to settle audit disputes, the law should have more mechanical specificity - akin to the model used by the UK Diverted Profits Tax. That approach would lessen uncertainty about how the law will be applied in practice. For example, the final Act should include clear criteria and controls on when the Commissioner can apply DPT and should not be left to ATO procedures. Further, the DPT legislation should require the ATO to draw on its existing tools before applying the DPT.

- The initial mid-year discussion paper on the DPT indicated that the DPT was to be applied only to uncooperative taxpayers; however, there is no test in the exposure draft to make this explicit. AmCham suggests adding one.

- The economic substance test will include not only tax benefits but also non-tax financial benefits, and neither this new element nor how it will be tested is defined in detail. As worded, it is unclear whether, in order for the economic substance exception to apply, the Commissioner is required to assess that the income derived by each foreign entity that is otherwise connected with the scheme (i.e. across the value chain outside the Australian jurisdiction) reasonably reflects the economic substance of each entity’s activities. To do so would give the ATO substantially increased extra-jurisdictional reach - exceeding the agreed scope of Base Erosion and Profit Shifting (BEPS).

- The sufficient economic substance test will be the primary exclusion for a lot of taxpayers and we consider it very important the scope of the exclusion be fully and comprehensively explained in the actual legislation rather than in the Explanatory Memorandum or ATO guidance. To deal with this issue, the Organisation for Economic Co-operation and Development (OECD) arms-length guidelines should be included in the Act. As Australia is an OECD member, we would expect the ATO to follow the OECD guidelines and its transfer pricing rules.

- The Explanatory Memorandum at paragraph 1.58 notes that in determining the economic substance of activities, the focus is on the active activities (and not the passive activities) of the tested entity. No explanation for ignoring the passive activities is provided and the restriction is not evident in the law itself.

There are situations such as a loan where the income being derived by parties reflects the risks that they are assuming rather than active activities and we believe that limiting the exclusion for sufficient economic substance to only active activities is overly and unnecessarily restrictive.

- The broad application of the proposed law combined with lack of specific tests in the legislation with regard to how it will apply creates investment uncertainty that is unhelpful for a government trying to attract foreign investment. For example, the Explanatory Memorandum should:

  - include specific tests for how the 80% tax threshold in foreign jurisdictions will be calculated

  - specify how the ATO will calculate the figure to which the 40% penalty tax rate will apply. For example, under the US tax law, an Australian company that is a subsidiary of a larger US based group of companies can be nominated to effectively be treated as a part of the groups US tax consolidated tax return. Where this happens, transactions between the Australian entity and other US companies in the US tax consolidated group will not give rise to any incremental US tax because they are essentially transactions within the tax consolidated group. However all of the operating income from the Australian company is simultaneously subject to both US and Australian income tax. To the extent there are mismatches between the Australian and US tax systems, these were intended to be addressed by the anti-hybrid rules. An Australian taxpayer that has been nominated to be a part of a US tax consolidated group would only be able to rely on the sufficient economic substance exclusion to avoid the application of the DPT even though all of the operating income from Australia would be subject to US tax.

    Another example is how offset of credits work in the calculation. In determining the foreign tax liability that may reasonably be expected to result from the scheme for the purposes of the sufficient foreign tax exclusion in Section 177K, it is unclear how foreign tax credits should be treated. The US foreign tax credit system is complex and can be difficult to forecast in practice. We recommend that the proposed DPT be clarified such that the sufficient foreign tax is determined prior to the application of any foreign tax credits.

- Denying a taxpayer subsequent to the review process the right to present all information before a Court (as opposed to only information presented to the ATO during the review process) would lack procedural fairness as it would be hard for a taxpayer to pre-empt all arguments and/or information that may be considered by the Court.

- In the event the taxpayer wins in court, we believe that the ATO should pay commercial rates of interest on company funds they are obliged to refund. The calculation of such to be clearly defined.

- In its current form, the DPT Exposure Draft is inconsistent with existing legislation, thereby creating uncertainty around when the DPT will apply and where traditional transfer pricing assessment will apply. Language used in the DPT should be consistent with:

  - that used in 2015 revisions to the OECD Transfer Pricing Guidelines, which has been agreed internationally

  - the "*reasonable to conclude*" language used in the DPT should be made consistent with existing "*objectively concluded*" language used in Part IVA of the *Income Tax Assessment Act 1936* where the DPT will reside

  - that used in Division 815 of the *Income Tax Assessment Act 1997*

- Inconsistency has the potential to substantially increase Australia's compliance costs in comparison to international peers. Consequently, multinational companies will need to make a separate DPT assessment across the value chain in Australia in additional to their existing transfer pricing assessments. This creates significant administrative burdens for companies considering investment in Australia as well as for existing companies that would need to conduct an entirely new form of assessment (potentially across several jurisdictions) because of an Australian law that is intended to apply only to uncooperative taxpayers.

Thank you for your consideration, and for this opportunity to submit AmCham's views on the Diverted Profits Tax Exposure Draft. We welcome any queries you may have regarding our submission and any opportunities to further engage in the consultation process.

Yours sincerely,

Niels Marquardt
Chief Executive Officer