ATO finalises its Diverted Profits Tax guidance

26 September 2018

Explore more insights

In brief

On 26 September 2018, the Australian Taxation Office (ATO) released its finalised Practical Compliance Guideline (PCG 2018/5) and Law Companion Ruling (LCR 2018/6) relating to Australia's Diverted Profits Tax (DPT).

The PCG was previously released as a draft version (PCG 2018/D2) for comment on 7 February 2018 (refer to our previous TaxTalk Alert). The LCR was previously released as a draft version (LCR 2017/D7) for comment on 21 December 2017 (refer to our previous TaxTalk Alert).

In finalising the PCG and LCR, the changes made to the previously issued drafts are not considered to be major, but do address a number of the matters that were raised during the consultation process and assist in clarifying how the DPT will be considered and administered by the ATO.

The updates can be summarised under the following categories:

- *Context and broader DPT criteria* - the draft PCG was narrowly focused on the sufficient economic substance (SES) test. The finalised PCG and LCR both emphasise broader DPT criteria (such as the existence of a tax benefit and the principal purpose test).
- *Approach to DPT compliance* - the finalised PCG explains that the DPT is not a provision of last resort but also states an expectation that the DPT will be applied in limited circumstances. However, it also highlights that the DPT may be considered concurrently with other tax rules such as the transfer pricing provisions.
- *Updated examples* - the finalised PCG now includes a low risk marketing hub example in relation to the oil and gas industry (previously there was only a high risk marketing hub example in relation to commodities). A high risk financing example has also been added in relation to cross currency interest rate swap arrangements only (previously the draft PCG did not include an example for financing transactions).

The finalised PCG serves as a risk assessment tool for taxpayers considering their potential exposure to the DPT and also acts as a framework document for taxpayers in determining the manner in which they should engage with the ATO.

The finalised LCR should be read in conjunction with the DPT legislation and explanatory memorandum when analysing the potential application of these provisions.

In detail

By way of background, Australia's DPT legislation applies to significant global entities (broadly, groups with annual global income of AUD1 billion or more) in respect of income years commencing on or after 1

July 2017 in circumstances where the amount of Australian tax paid is reduced by diverting profits offshore through related-party arrangements and certain other conditions are satisfied. A tax of 40 per cent applies to DPT tax benefits irrespective of whether or not the tax benefit arises in connection with a scheme that was entered into, or was commenced to be carried out, before 1 July 2017. Refer to our TaxTalkAlert, published on 10 February 2017, for detailed background.

Our expectation in relation to the DPT, and the expectation of the ATO, is that taxpayers will review the PCG in an attempt to perform their own risk assessment for potential DPT exposure based on the legislation itself, the LCR, the PCG framing questions provided and suggested documentation/evidence.

In the event that taxpayers conclude that there is a potential DPT risk associated with their arrangement(s), taxpayers can consider engaging with the ATO in order to obtain greater certainty on the application (or otherwise) of the DPT. The ATO's suggested avenues for engagement include entry into the advanced pricing agreement (APA) program, applying for a private ruling, or contacting the ATO's specialist DPT team.

The finalised examples which illustrate the ATO's approach to risk assessment in relation to the SES are listed below:

- Lease-in lease-out arrangements
- Intangibles migration (pharmaceutical industry specific)
- Intangibles migration (previously described as a run-up run-down arrangement)
- Distributor arrangements (previously described as a limited-risk distributor arrangement)
- Marketing hub arrangements
- Financing arrangement (involving a cross currency interest rate swap), and
- Insurance arrangements.

A concern remains that many taxpayers will have circumstances that do not fit neatly into the examples provided in the finalised PCG and therefore it may be difficult to predict the level of risk perceived by the ATO in many circumstances. Regardless, the ATO expects taxpayers to engage with them if "there is a potential DPT risk associated with your arrangement", having regard to the PCG's risk assessment framework.

The takeaway

All taxpayers with cross-border related party dealings are encouraged to assess the potential application of the DPT. This will start with the preliminary consideration of whether the taxpayer is a significant global entity that has, in broad terms, Australian income in excess of AUD25 million, and then a specific consideration of particular transactions within the framework of the DPT law.

Beyond these initial framing questions, we recommend that taxpayers undertake a process to evaluate their risks and supporting documentation for the more complicated areas of the DPT law, namely the principal purpose test and whether it could be concluded that an Australian tax benefit exists, as well as the SES and sufficient foreign tax tests.

The ATO's finalised DPT materials should be considered by all affected entities in framing up an assessment of the potential application of the DPT and the likely approach to be taken to engage with the ATO in managing compliance risk.

Let's talk

For a deeper discussion of how these issues might affect your business, please contact:

Michael Bona, Brisbane
+61 (7) 3257 5015
michael.bona@pwc.com

Peter Collins, Melbourne
+61 (3) 8603 6247
peter.collins@pwc.com

Jonathan Malone, Sydney
+61 (2) 8266 4770
jonathan.r.malone@pwc.com

Greg Weickhardt, Melbourne
+61 (3) 8603 2547
greg.weickhardt@pwc.com

Chris Morris, Sydney
+61 (2) 8266 3040
chris.j.morris@pwc.com

Paul McNab, Sydney
+61 (2) 8266 5640
paul.mcnab@pwc.com

James Nickless, Sydney
+61 (2) 8266 3246
james.nickless@pwc.com

Angela Danieletto, Sydney
+61 (2) 8266 0973
angela.danieletto@pwc.com

© 2018 PricewaterhouseCoopers. All rights reserved. In this document, "PwC" refers to PricewaterhouseCoopers a partnership formed in Australia, which is a member firm of PricewaterhouseCoopers International Limited, each member firm of which is a separate legal entity. This publication is a general summary. It is not legal or tax advice. Readers should not act on the basis of this publication before obtaining professional advice. PricewaterhouseCoopers is not licensed to provide financial product advice under the Corporations Act 2001 (Cth). Taxation is only one of the matters that you need to consider when making a decision on a financial product. You should consider taking advice from the holder of an Australian Financial Services License before making a decision on a financial product.

Liability limited by a scheme approved under Professional Standards Legislation.

WL12705