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# *Diverted Profits Tax: Australia passes new law to combat multinational tax avoidance*

29 March 2017

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## *In brief*

- On 27 March 2017, the Australian Parliament legislated a diverted profits tax (DPT). As the most expansive cross-border tax change in generations, and as described in our earlier [TaxTalk Alert on 10 Feb 2017](#), the DPT imposes a penalty rate of tax (40 per cent) to profits diverted offshore through related party arrangements. The DPT applies for income years starting on or after 1 July 2017 irrespective of whether the particular arrangements were entered into before that time.
  - The Bills passed by Parliament also include a measure to increase administrative tax penalties by hundreds of times for taxpayers with total group-wide global income (broadly, revenue) exceeding A\$1 billion (approximately USD750m, EUR700m). For example, late lodgement of a tax document (including income tax returns, business activity statements, country-by-country reporting documents and general purpose financial statements) by even one day carries a potential penalty starting at A\$105,000 (up from A\$180) and with a maximum penalty of A\$525,000. This measure will generally apply from 1 July 2017.
  - The Bills also codify the Actions 8-10 Final Report from the Organisation for Economic Co-Operation and Development's (OECD's) base erosion and profit shifting (BEPS) project into Australian transfer pricing laws. This measure applies for income years starting on or after 1 July 2016.
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## *In detail*

The broad impact of the DPT comes about because it can apply to any Australian cross-border arrangements (including, unlike the UK DPT, financing transactions), provided at least one foreign associate taxpayer is involved and total group-wide global income (broadly, revenue) is at least A\$1 billion (approximately USD750m, EUR700m). The only exemptions are for managed investment trusts, certain foreign collective investment vehicles, entities owned by foreign governments, complying superannuation entities and foreign pension funds.

If it applies, the DPT is a 40 per cent rate penalty tax (compared to the Australian 30 per cent corporate tax rate), plus interest. A DPT assessment can be issued any time within seven years of the original

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income tax return assessment, with taxpayers then required to pay a DPT assessment in full before the assessment can be contested or a settlement reached with the Australian Taxation Office (ATO).

The DPT has been designed so that, in face of a threat of DPT and its upfront tax collection process, taxpayers will more readily provide to the ATO information regarding their earnings and taxes throughout their global value chains.

As described in our [TaxTalk Alert on 10 Feb 2017](#), the DPT is incorporated into Australia's existing anti-avoidance rules in Part IVA. These rules require an objective conclusion to be made that there was a tax purpose associated with the arrangements being examined. The DPT adopts a 'principal purpose' test. This is clearly and intentionally a lower hurdle compared to the 'sole or dominant purpose' test within the 'original' Australian general anti-avoidance provision. Significantly, 'principal purpose' is also determined not just on the basis of a principal purpose to obtain an Australian tax benefit, but also to obtain both an Australian tax benefit and reduce foreign tax liabilities. Therefore, tax arrangements outside of Australia may be of interest to the ATO.

Practically, it will be necessary to consider the impact of DPT on existing positions taken even where these may have been considered and accepted by the ATO (e.g. through a tax ruling, Advanced Pricing Agreement or tax audit). This is because the DPT has a retrospective element and can apply to arrangements entered into before 1 July 2017.

The DPT is incorporated into Australia's anti-avoidance rules and, as a result, there is no recourse to double tax relief under Australia's tax treaties, nor to the arbitration mechanisms anticipated by the OECD's Multilateral Instrument. The only avenue to object beyond the ATO is to the Australian Federal Court.

The DPT legislation passed remained largely unchanged from the legislation introduced into Parliament on 9 February 2017. The Government implemented a single technical amendment designed to ensure that a DPT tax benefit is only to be reduced if the diverted profits are included in Australian assessable income as a result of Australia's controlled foreign company rules.

A Senate Report released on 20 March 2017 noted concerns raised by stakeholders regarding the unilateral implementation of a DPT in Australia but concluded that the DPT was a "necessary step to promote greater compliance and deter significant global entities from gaming the system."

The Government originally announced in May 2016 that the DPT would be based on the second limb of the UK DPT. However, the Australian DPT now diverges significantly from the UK DPT. This is not just because of the higher DPT rate (40 per cent, compared to 25 per cent for the UK) and inclusion of financing transactions (which are exempt from UK DPT). For example, the Australian DPT sufficient economic substance exemption requires a multi-sided functional analysis and profit comparison of every entity, Australian and foreign, involved in the global value chain relevant to Australia. A further example is the sufficient foreign tax test which makes no allowance for tax losses.

According to the Explanatory Memorandum, the ATO would publish a so-called law companion guide on the application of the DPT when the legislation is introduced into Parliament. This material has not yet been issued but is expected soon. We will provide a further DPT update once this guide is released.

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## ***The takeaway***

Overall, the DPT is extremely broad and has the potential to apply to a significant number of multinational groups – the Government has predicted that 1,600 entities will be need to consider if the DPT may apply and 130 taxpayers have a high risk of a DPT exposure. We anticipate it will create uncertainty for many taxpayers with international operations.

## ***Let's talk***

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

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