Roundup of Australia's BEPS developments

12 April 2017

In brief

Since its presidency of the G20 in 2014, Australia has been at the forefront of efforts to combat tax avoidance by multinational enterprises (MNEs). Building on already strong anti-avoidance rules within the existing tax framework, Australia has been aggressively introducing new laws to give effect to the recommendations from the Organisation of Economic Cooperation and Development (OECD) and G20 Base Erosion and Profit Shifting (BEPS) Action Plan, and in some respects going beyond these rules.

At a time when the question of whether multinationals are paying their "fair share of tax" remains high on the public's radar, the Australian Government continues to implement reforms that not only strengthen the integrity of the tax system, but aim to encourage transparency in taxes paid by MNEs to build confidence in the Australian tax system. Reforms that are aimed at strengthening the tax system such as those that ensure profits are taxed where they are earned, prevent abuse of the tax system, prevent double taxation, and create certainty, must be welcomed. However, reforms must also be balanced against Australia's desire to create an environment that is attractive to foreign investment.

In this publication we provide an update on the status of implementation of all BEPS-related measures in Australia, including those that originate from the OECD BEPS project recommendations and other stand-alone measures that are aimed at combating erosion of the tax base.

In detail

Over the past five years or so, successive Australian governments have attempted to position Australia as a world leader in the fight against the erosion of the tax base by MNEs. On top of an already robust tax anti-avoidance framework which has been in place since 1981, Australia has committed to implementing most of the recommendations resulting from the ongoing work of the OECD and G20 BEPS Action Plan.

At the time the OECD released the Final Reports on the BEPS Action Plan in October 2015, Australia had already introduced a range of measures to combat tax avoidance by MNEs. Treasurer Scott Morrison stated at the time:

> "The Australian Government is proud to have led the way globally in this fight against tax avoidance during its G20 Presidency in 2014 and we now have some of the strongest tax integrity rules in the world."

Although some of the measures below will apply to all Australian taxpayers, some are aimed specifically at large MNEs, and this has been achieved by recognising in Australia's domestic tax law a new type of taxpayer - a Significant Global Entity. In broad terms, an Australian taxpayer will be a Significant Global Entity if it has annual global income of A$1 billion or more, or it is a member of a group of entities that is consolidated for accounting purposes and the group has annual global income of at least A$1 billion.

Status of implementation of OECD BEPS Actions

Firstly, in summary, the following table provides a status report on Australia's approach to adopting the 15 BEPS Action Items.

OECD BEPS Action	Status	Australian action *
Action Item 1: Tax Challenges of the Digital Economy	✓	Digital economy issues addressed by other Action Items. The Government has introduced an integrity measure to apply the Goods and Services Tax (GST) to digital products and services imported by Australian consumers with effect from 1 July 2017.
Action Item 2: Neutralise hybrid mismatch across borders allowing double taxation	In progress	Government has announced it will implement anti-hybrid measures with minor modifications.
Action Item 3: Controlled foreign company (CFC) rules	✓	Australia's CFC rules currently meet OECD best practice guidance
Action Item 4: Limit interest deductions	✓	Australia has already tightened its thin capitalisation rules with a general "safe harbour" 1.5:1 debt:equity ratio
Action Item 5: Counter harmful tax practices	✓	The Australian Taxation Office (ATO) has already implemented a process for the exchange of rulings
Action Item 6: Prevention of treaty shopping	✓	To be adopted into negotiation of new / updated treaties (e.g. new tax treaty with Germany recently entered into force)
Action Item 7: Prevent artificial avoidance of permanent establishment	✓	Australia's new Multinational Anti-Avoidance Law (MAAL) is consistent with this item (see discussion later) and applies from 1 January 2016. Other OECD recommendations are in line with Australia's treaty practice
Action Items 8, 9 and 10: Transfer pricing and value creation	✓	Legislation has been introduced to adopt the revised transfer pricing guidance issued by the OECD in 2015 it its final report of Actions 8-10.
Action Item 11: Methodologies to collect and analyse BEPS data	Further work to be done	Estimate of BEPS problem 4-10 per cent of global corporate income tax revenue. Further work on methodologies to measure progress required
Action Item 12: Mandatory disclosure of aggressive tax	In progress	Government has announced that a mandatory disclosure regime will be introduced in Australia

planning		
Action Item 13: Transfer pricing documentation and country-by-country reporting	✓	Country-by-country reporting, local file and master file documentation requirements are in place for Significant Global Entities from 1 January 2016
Action Item 14: Dispute resolution	✓	A number of countries (including Australia) are committed to binding arbitration
Action Item 15: Multilateral instrument	In progress	Government is considering extent to which this will be adopted, at the time of writing, no final decision made as yet

** Based on Treasurer's media release "OECD report supports Australian Government action on multilateral tax avoidance" issued on 6 October 2015, updated for recent developments.*

Transfer Pricing

Australia has implemented a number of changes to strengthen its transfer pricing rules over the last five years or so. One of those key changes related to the record keeping requirements to support a pricing position taken by a company. Although it is not mandatory for a company to keep contemporaneous transfer pricing records, the keeping of such records are necessary to establish a reasonably arguable position. That is, if the documentation is not kept as specified in the law in respect of a matter, the entity is not able to demonstrate that it has a reasonably arguable position in relation to that matter which means that in the event of a transfer pricing adjustment made by the Commissioner of Taxation, higher penalties are imposed.

More recently, in line with the OECD BEPS project, Australia's tax law has been amended to implement Country-by-Country (CbC) Reporting and to legislatively recognise the changes made in the 2015 OECD Transfer Pricing Guidance.

Implementation of CbC Reporting

The legislative framework giving effect to the implementation of the CbC reporting requirements for Australia was enacted in December 2015. These reporting requirements apply to income years commencing on or after 1 January 2016.

Broadly, regardless of the size of the Australian operations, CbC reporting applies to Australian taxpayers that are Significant Global Entities. Within 12 months after the end of its income tax year, a Significant Global Entity is required to provide the Australian Taxation Office (ATO) with three statements - a CbC report, a local file and a master file.

CbC Report
The CbC Report that is required to be lodged with the ATO is consistent with the OECD recommended CbC Report. The global head company of the group is required to prepare and lodge a CbC Report with the revenue authority in its home jurisdiction annually. This is then exchanged with revenue authorities in jurisdictions in which the group has a presence. The report provides information about where economic activity is undertaken and profits are reported by multinational groups and as such, will set out, inter alia, a list of the group entities by jurisdiction, together with information about revenue, assets, head-count, actual tax paid and income tax expenses in each jurisdiction.
Master File
Like the CbC Report, the Master File required to be lodged with the ATO is consistent with the OECD Master File. The purpose of the Master File is to provide a descriptive overview of the group and its

transfer pricing policies to revenue authorities in jurisdictions in which the group has a presence. The Master File focuses on qualitative analysis including, inter alia, a description of the global value chain, where intellectual property is held, who performs functions and manages risk for generating value and intellectual property, intra-group services and financing.

Local File

The Australian Local File (the Local File) is based on the OECD requirements, however unlike the Master File and CbC Report, it is tailored to suit the ATO's risk-assessment purposes and is different in both form and content from the OECD local file.

The Local File must be filed in a prescribed electronic format which requires reporting of all transaction values in categories defined by the ATO, including the name and jurisdiction of each related counterparty. The manner in which the lodgement is required will, at present, require either the development of internal business software or the use of an external provider.

The entity has a choice to lodge the Australian Local File with their tax return or lodge the separate International Dealings Schedule with their tax return and the local file six months later. A short form Australian Local File is available for taxpayers under certain materiality thresholds and reporting requirements are reduced for certain types of transactions. Material related party contracts, relevant foreign APAs, as well as the management reporting structure will also need to be lodged with the local file.

It is important to note that the Australian Local File differs from traditional transfer pricing documentation, which Australian entities should also prepare, for the purposes of penalty protection. Detail regarding the requirements of the Australian Local File are summarised in PwC's Tax Insights from Transfer Pricing, dated 1 June 2016.

To the extent that the global head company of the group is not required to lodge the CbC Report or Master File under the domestic laws of its home jurisdiction, the ATO can exercise its discretion to exempt Australian subsidiaries from having to lodge these reports. However, we note that this involves undergoing a formal exemption engagement with the ATO and is subject to certain requirements being met.

Adoption of OECD Guidelines

The Australian Government has recently amended the transfer pricing provisions to include the revised OECD Transfer Pricing Guidance issued by the OECD in 2015 in its "Aligning Transfer Pricing Outcomes with Value Creation – Actions 8 to 10, Final Reports" of the BEPS project.

This change means that Australian taxpayers will need to consider the new OECD Transfer Pricing Guidance when they self-assess whether they have complied with the Australian transfer pricing rules for years beginning on or after 1 July 2016 and in order to satisfy the documentation standard required for transfer pricing penalty protection. For some taxpayers this may require a more thorough global value chain analysis.

The changes issued by the OECD in 2015 introduce a much stronger focus on substance over legal form (which is broadly consistent with the approach Australia has adopted in its domestic transfer pricing rules). Specific changes in the 2015 OECD Transfer Pricing Guidance which are now embedded into Australia's transfer pricing rules include:

- A framework for analysing risk allocations between related parties, focusing on which entities have the decision making and financial capacity to take on and manage key risks.
- Guidance on the 'accurate delineation of transactions' which addresses when re-characterisation or non-recognition of transactions may be appropriate.

- Detailed new guidance on the transfer pricing considerations for intangibles which focuses heavily on aligning intangible related profits with the performance of functions, assets and risks related to the development, enhancement, maintenance and protection of the intangible.
- Revised guidance on cost contribution arrangements.
- Guidance on transfer pricing for low value adding intra-group services (e.g. routine management services).

Anti-avoidance rules

Australia's general anti-avoidance rules (GAAR) have been in place for over 35 years and have been, and continue to be, an important feature in Australia's income tax law to protect the revenue base. Although these provisions were relatively recently tightened, further legislative amendments have been made with a focus specifically on BEPS activities of Significant Global Entities - a Diverted Profits Tax and a specific multinational anti-avoidance law - and further reforms (such as anti-hybrid reforms) are yet to come potentially affecting any multinational.

Diverted Profits Tax

Australia is one of only two countries to have implemented a Diverted Profits Tax (DPT) to combat base erosion and profit shifting.

The introduction of the DPT is the biggest change in Australia's GAAR since their introduction 35 years ago. The DPT will apply to Significant Global Entities with respect to tax benefits arising in income years starting on or after 1 July 2017.

In broad terms, the Australian DPT is a penalty tax (40 per cent) that will be imposed in circumstances where the amount of Australian tax paid is reduced by diverting profits offshore through related-party arrangements. The DPT is extremely broad (for example, both financing and non-financing arrangements are in scope), and will apply to a significant number of multinational groups and will create uncertainty to affected entities. For further details regarding the DPT, refer to our TaxTalk Alert, dated 10 February 2017.

Multinational Anti-Avoidance Law

The Multinational Anti-Avoidance Law (MAAL) amended Australia's anti-avoidance rules by introducing a targeted anti-avoidance law that applies to multinationals that supply goods or services to Australian customers and record the revenue from those sales overseas.

Specifically, the MAAL applies to Significant Global Entities from 1 January 2016. The law will apply where an Australian related entity of the foreign seller performs activities connected with the sales (such as marketing services), and it would be concluded that the arrangement was entered into with a principal purpose of avoiding tax in Australia or reducing their foreign tax liability.

Where the MAAL applies, the foreign entity will be taxed as if it had made the sales through a deemed Australian permanent establishment (PE) and will be subject to Australian income tax on the notional profits attributable to the deemed PE. There could also be withholding taxes imposed. Penalties will apply on top of these taxes, generally at a rate of 100 per cent.

Eliminating hybrid mismatch arrangements

The Australian Government has committed to implement the OECD's rules to eliminate hybrid mismatch arrangements (Action 2 of the OECD's BEPS Action Plan), with some minor modifications as recommended by the Board of Taxation in its report to the Government on implementation options.

Whilst the detail of how these rules will be enacted into the Australian tax law is unknown, it is broadly expected to follow the Action 2 report recommendations that hybrid arrangements will be neutralised as follows:

- Where there is a deduction/no inclusion outcome - deny the payer the deduction (primary response) or require the inclusion of the income (secondary response).

- Where there is a double deduction outcome for a single expenditure - deny the deduction in the parent jurisdiction.

It is anticipated that there will also be rules to restrict access to the dividend exemption and foreign tax credit relief, and to address imported mismatch arrangements, as recommended by the OECD. The OECD recommendations regarding reverse hybrids will not be implemented immediately, but may be considered if integrity concerns arise in the future.

The Government has indicated that the anti-hybrid rules will apply to payments made on or after the later of 1 January 2018 or six months after the relevant law is enacted. It is expected that there will be no transitional rules or grandfathering of pre-existing arrangements.

Revisiting Australia's tax treaties

Australia currently has a comprehensive tax treaty network covering more than 45 jurisdictions. Although the Australian Government has indicated that it is likely to sign the OECD's Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (the Multilateral Instrument), it is worth noting that a revised tax treaty with the Federal Republic of Germany which entered into force late last year, become Australia's first '21st century' threat to incorporate the OECD's BEPS recommendations.

In a Treasury discussion paper (released in December 2016) seeking views on the potential impacts of Australia adopting the Multilateral Instrument, it is noted that "adopting it to the widest possible extent would be consistent with Australia's strong track record on tackling multinational tax avoidance". The Multilateral Instrument will provide participating jurisdictions with a means to swiftly modify their bilateral treaties to implement BEPS measures without have to negotiate changes on a treaty by treaty basis.

In Australia's case, the Multilateral Instrument would still need to be legislated and then formally ratified. As a result, if adopted, it is expected that it could potentially take effect in Australia from 1 January 2019 (for rules relating to withholding taxes) and 1 July 2019 (for rules relating to other taxes), subject to its ratification by Australia's treaty partners.

As mentioned earlier, the new tax treaty with Germany gives effect to a number of BEPS measures and provides a good insight into the model likely to be adopted by the Australian Government for future treaty negotiations, including:

- The title and preamble indicate the purpose of the treaty is not merely to eliminate double taxation and prevent fiscal evasion, but to also address tax avoidance.
- Adopting a six and twelve month holding period condition to access certain concessional dividend withholding tax rates, and in respect of the alienation of property, introducing a 365 day test period for determining whether shares or comparable interests derive more than 50 per cent of their value from immovable property located in Australia or Germany.
- A revised Limitation of Benefits article incorporating a new 'Principal Purpose Test' and strengthening of the Permanent Establishment article.
- Denial of treaty benefits to certain fiscally transparent entities (i.e. where neither country treats the income of a fiscally transparency entity as the income of one of its residents under the domestic law).

For more information regarding the BEPS features in the new tax treaty between Australia and Germany, please see our TaxTalk Alert dated 25 October 2016.

Australia's commitment to arbitration and mutual agreement procedures

Australia has committed to making dispute resolution mechanisms, in particular mutual agreement procedures (MAP), more effective in accordance with Action 14 of the OECD BEPS Action Plan. This includes strengthening mechanisms to improve the resolution of cases under the existing MAP in order to address a breakdown in confidence that has occurred as a result of an escalating number of MAP cases and longer periods to resolve, together with MAP being a process in which taxpayers do not formally participate.

The strengthening of MAP will be reinforced through the adoption of the Multilateral Instrument, in particular Article 16. Article 16 is broadly designed to provide taxpayers with a more effective tax treaty based dispute resolution procedure so that actions to counter BEPS do not inadvertently lead to double taxation. The Treasury discussion paper on Australia's adoption of the Multilateral Instrument released in December 2016, notes that Article 16 of the Multilateral Instrument in relation to MAP will be adopted in full. This approach is also consistent with Australia's preferred treaty practice (for example, as applicable under the new tax treaty with Germany).

Responding to the growing digital economy

On 1 July 2017, new laws will come into effect to extend Australia's goods and services tax (GST) to cover digital products and services supplied by non-residents to 'Australian consumers'. The law changes will result in supplies of digital products, such as streaming or downloading of movies, music, apps, games and e-books, and services such as on-line consultancy and professional services receiving similar GST treatment whether they are supplied by a local or foreign supplier.

These new measures may require a non-resident supplier to register and account for GST in Australia. In this regard, there is elective regime for simplified and limited registration which also restricts participating taxpayers from claiming input tax credits on related costs. However, in many circumstances responsibility for the GST liability that arises under this regime will be shifted from the supplier to the operator of an electronic distribution platform. This will occur where the operator controls any of the key elements of the supply such as 'product' delivery, charging or setting terms and conditions. Shifting responsibility for the GST liability to operators is intended to minimise compliance costs as operators are generally better placed to comply with the new law. However, this additional collection responsibility may add significant risk, and compliance and systems costs for the intermediary.

Reporting and transparency

In addition to the new transfer pricing documentation and reporting obligation highlighted above, Australia has a multi-faceted reporting and transparency regime aimed at tackling BEPS. This includes measures aimed at increasing both public transparency (i.e. releasing information to the public) and regulatory transparency (i.e. providing more information to the tax authorities).

The following table summarises the reporting and transparency measures currently in place or proposed in Australia.

Initiative	**Details**
Publishing of tax return information	The Commissioner of Taxation has an obligation to annually publish selected tax information from income tax returns lodged by companies with total income of A$100 million or more (except Australia-owned private companies with total income of less than A$200 million). The Commissioner produces an annual report containing the following information for affected companies: • Name • Australian Business Number • Total income for the year • Taxable income (if any) for the year • Income tax payable (if any) for the year.

General Purpose Financial Reports	From 1 July 2016, significant global entities are required to lodge General Purpose Financial Reports with the ATO if they do not have an obligation to lodge these with the Australian Securities and Investment Commission (ASIC).
Mandatory disclosure of tax information	The Australian Government has committed to implementing the OECD's proposals for mandatory disclosure of tax information under Action 12 of the BEPS Action Plan. Broadly, this proposal will required tax advisers (and, in some circumstances, taxpayers) to make early disclosures to the ATO of aggressive tax arrangements, with a view to providing it with timely information on arrangements that have the potential to undermine the integrity of the income tax system. The final form of the rules and application date is unknown.
Voluntary Tax Transparency Code	The Australian Government is encouraging all companies to adopt a new Voluntary Tax Transparency Code with effect from the 2016 financial year. The Code, which was developed by Australia's Board of Taxation, comprises a set of additional minimum disclosures of tax information for 'large businesses' (Australian turnover of at least A$500 million) and slightly less disclosure for 'medium businesses' (Australian turnover at least A$100 million but less than A$500 million). The Code is voluntary and there are no financial penalties for failing to comply or providing misleading information.
Common Reporting Standard	Australia has implemented the OECD's Common Reporting Standard (CRS) for automatic exchange of financial account information. Under the CRS, Australian financial institutions are required to carry out due diligence procedures to identify the tax residence of account holders and report relevant data to the ATO. The Commissioner will then provide this information to tax authorities in other jurisdictions and similarly will receive information on Australian tax residents with financial accounts held overseas from those jurisdictions which have also implemented the CRS. The first reporting period under the CRS in Australia is 1 July 2017 to 31 December 2017, and then every subsequent calendar year. The Commissioner of Taxation also has an obligation to publish an annual report providing aggregated, de-identified data on the financial holding of foreign nationals in Australia.
Third party reporting	The Australian Government has introduced a third party reporting regime designed to provide the ATO with more data for pre-filling of income tax returns for individuals and for compliance and data matching activities. Under this regime, affected entities (including government-related entities, ASIC, listed companies and trusts, fund managers and custodians, and banks) have an annual obligation to report information to the ATO regarding a wide range of transactions such as government grants and payments to suppliers, transfers of real property, transfers of shares and units and business payments. This regime commenced 1 July 2016 for transfers of real property and for reporting by ASIC, and from 1 July 2017 for all other reporting.

Tougher administration by the revenue authority

The ATO, as the tax revenue authority in Australia, has come under significant pressure in recent times to show that MNEs in Australia are paying their "fair share of tax", and this has resulted in a number of new, and generally more aggressive, approaches from the ATO.

The table below outlines some of the new initiatives from the ATO that are designed to both protect the tax base and provide taxpayers with guidance to deal with the increasing volume of new and complex tax laws.

Law Companion Guidelines (LCGs) LCGs provide the ATO's view of recently enacted law and are binding public rulings which can be relied on and provide protection from penalties if they are relied on by taxpayers in good faith.	***Practical Compliance Guidelines (PCGs)*** PCGs are ATO publications which provide taxpayers with identifiable, coherent and broad 'law administrative guidance' that conveys the ATO assessment of tax compliance risk across a spectrum of behaviours or arrangements. These are not binding and do not provide the same level of protection as a public ruling, but can help taxpayers identify arrangements that are likely or unlikely to attract the ATO's attention.
Taxpayer Alerts Taxpayer Alerts are issued by the ATO as an early warning about arrangements that the ATO considers may be high risk or is currently under risk assessment. There has been an increasing trend in the issue of Taxpayer Alerts targeting a range of different types of domestic and also cross-border arrangements.	***Reportable Tax Position Schedule*** The Reportable Tax Position Schedule was introduced as an extension of the Company income tax return several years ago to give the ATO an additional avenue for identifying high risk transactions. The ATO has recently completed a review of the Schedule and will introduced major enhancements for the 2017 year. One of the key changes applicable in 2017 will be a new category of reportable transactions, that will require taxpayers to disclose whether they have entered into any transactions that the ATO has identified as "high risk" in its public guidance (for example, in a Taxpayer Alert).
Tax Governance and Review Guide The ATO has recently published a substantial update to its Tax Risk Management and Governance Review Guide, containing new guidance for directors of companies and recommended self-assessment procedures. This update aims to assist organisations understand the ATO's shift beyond checking whether policies exist to testing whether tax risk management processes and procedures are operating effectively. The ATO expects that directors should oversee an internal control framework which provides guidance on how all risks, including tax risks, are identified and managed within the business. For more information please see our TaxTalk Alert dated 22 February 2017.	

The Australian Government has also provided the ATO with a powerful new weapon in its fight against tax avoidance in the form of harsher penalties for a Significant Global Entity that fails to comply with Australia's tax laws. These include:

- Doubling of penalties from 1 July 2015 for transfer pricing and anti-avoidance 'schemes', up to 100 per cent of the tax shortfall.
- Doubling of penalties from 1 July 2017 for making a false or misleading statement to the ATO (including within any tax return or document lodged with the ATO), potentially up to 150 per cent of the tax shortfall where there has been intentional disregard of the law.

- Penalties to be multiplied by 500 from 1 July 2017 for failure to lodge documents required to be lodged with the ATO on time. This will range from A$105,000 for a document that is lodged up to 28 days late, up to a maximum of A$525,000 for a document lodged more than 112 days late.

The takeaway

The OECD's BEPS project marks a significant change in the international tax landscape, and Australia has been, and continues to be, at the forefront of this change. As can be seen above, the quantity and complexity of these changes is significant, and there is no sign of this trend slowing down. Companies operating in Australia should prepare early for these changes, as the consequences can range from increased tax costs of operating in Australia in the form of compliance costs associated with new reporting requirements, and potentially significant penalties for failing to meet tax obligations.

Let's talk

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

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