Australia
Diverted profits to be taxed at 40%

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Report from Tom Toryanik, Singapore

On 3 May 2016, the Treasury announced consultations on the proposed diverted profits tax (DPT), modelled after a similar tax recently introduced in the United Kingdom. The DPT was announced in today’s Budget and will apply from 1 July 2017.

Australia has already introduced the Multinational Anti-Avoidance Law (MAAL) that replicates the first limb of the UK DPT and applies where multinational entities use tax-driven arrangements to avoid a taxable presence in Australia. The DPT consultation paper, however, states that the MAAL can be difficult to apply and enforce, presumably as a reference to certain uncooperative private equity firms refusing to pay their fair share of tax in Australia. In other words, the MAAL will be deployed against cooperative taxpayers that provide information to the ATO.

To deal with uncooperative taxpayers, the government proposes to introduce the DPT that will allow the ATO to impose a penalty tax rate based on information available to the ATO at the time, to require the tax to be paid upfront and to restrict the taxpayer from challenging the DPT for more than 12 months.

Briefly, the DPT will be imposed at a rate of 40% on profits transferred offshore through related party transactions with insufficient economic substance that reduce the tax paid on the profits generated in Australia by more than 20%. As the headline tax rate is 30%, the existence of profits “generated” in Australia and taxed elsewhere at a tax-haven rate of 26% will be sufficient for the ATO to require the taxpayer to pay a “tax” calculated at 12% (40% of the deemed 30% diverted profits, see below) of the taxpayer’s related party dealings on a reasonable suspicion that the dealings were not conducted at arm’s length. In order to calculate the tax liability, the ATO will be allowed to reconstruct an alternative arrangement that, in the ATO’s view, would be less contrived and more appropriate for the taxpayer – for example by deeming that 30% of the taxpayer’s related party costs represent diverted profits and taxing these profits at the 40% DPT.

Only global entities with annual global group turnover of AUD 1 billion or more will be subject to the DPT. While DPT is not intended to apply to global entities with Australian group turnover (across all related Australian entities) of less than AUD 25 million, this exemption is calculated to include turnover from contrived arrangements, which makes the exemption somewhat meaningless.

In order for the DPT to apply, there must be an effective tax mismatch together with insufficient economic substance.

The effective tax mismatch happens where dealings between an Australian taxpayer and a related overseas entity result in a reduction of a tax liability of the Australian taxpayer that exceeds the corresponding increase in a tax liability of the related overseas entity by more than 20% (in other words, an Australian deduction of AUD 100, with income elsewhere of AUD 80 taxed at 30%, or perhaps income of AUD 100 taxed at 24%). In calculating the mismatch, different tax rates, tax reliefs and exemptions are disregarded, as are losses available to the related overseas party. In the mismatch calculation, the tax liability refers to Australian and foreign income taxes only and cannot take into account other taxes (presumably taxes such as the UK DPT).

Insufficient economic substance takes place merely where it is reasonable for the ATO to conclude, based on information available to the ATO at the time, that the transaction was “designed” to secure the tax reduction. The reference to the design of the transaction is not clear, nor is the reference to a tax reduction. In any case, it appears that if the affected taxpayer fails to provide information to the ATO in time that could allow the ATO to perhaps to make a different conclusion, the making of the decision based on whatever information were available at the time would be sufficient for the DPT to apply.

In fact, it appears that the taxpayer is not even required to provide any information to the ATO, in which case the ATO may deem the diverted profits to be 30% of the expenses of the taxpayer that the ATO considers to be not at arm’s length. As shown below, the taxpayer will even be prevented to challenge such a non-arm’s length assumption by the ATO. If there are no transaction expenses to which the 30% rate can be applied, the calculation is simply based on the best estimate that the ATO can make at the time.

In calculating the amount of DPT payable, the DTP assessment will be reduced by Australian taxes paid on the diverted profits, including withholding tax, but a credit will not be given for any tax paid in a foreign jurisdiction. The amount due will be increased by an interest charge. The DPT will not be a deductible expense, but will give rise to a franking credit, limited to the applicable company tax rate.

The DPT assessment can be issued within 7 years after the filing of the income tax return for the year in respect of which the assessment is made, with the taxpayer having 60 days to correct factual matters in the assessment. However, within these 60 days...
the taxpayer is not allowed to introduce any transfer pricing matters. After the 60-day period, the ATO will finalize the DPT assessment and the taxpayer will be required to pay the DPT within 21 days without any rights to appeal or stay the payment.

Following the payment of the DPT, the taxpayer will have 12 months to provide to the ATO additional details, including transfer pricing information. During these 12 months, based on the additional information provided by the taxpayer or sourced by the ATO elsewhere, the assessment may be increased or decreased by the ATO.

Furthermore, during the 12-month review period, the taxpayer may amend the relevant income tax return to reflect the transfer pricing outcome in line with the DPT assessment, in which case the DPT will be correspondingly reduced (at 40%) and the additional income tax (at 30%) and penalties (presumably at 50% of the additional tax) from the transfer pricing amendments correspondingly increased. Today’s budget announcement includes a somewhat obscure announcement that may increase the penalties to 100% of the additional tax, in which case the affected taxpayer may be somewhat disincentivized to agree to transfer pricing amendments.

It is only after the expiration of the 12 months that the taxpayer will be able to appeal the DPT assessment. However, it appears that the grounds for the appeal could be somewhat limited, as the ATO may be able to claim that the DTP assessment was based on the information available to the ATO at the time and therefore cannot be contested.

The Treasury invites interested parties to comment on the DPT consultation paper. The closing date for submissions is 17 June 2016.

See also

Australia-2, News 3 May 2016
Australia - Corporate Taxation - Country Surveys sections 1.3.3., 1.3.4., 1.6., 1.7., 7.1., 7.2., 8.3.
Australia - Individual Taxation - Country Surveys section 1.4.
Australia - Corporate Taxation - Country Analyses sections 1.4.8., 1.5., 1.9.5.1., 1.10., 1.11.5., 2.3.2., 10.1.1., 10.2., 13.3.
Australia - Individual Taxation - Country Analyses section 1.4.1.
Australia - VAT & Sales Tax section 3.
Australia - Transfer Pricing section 13.3.