

Taxation Update

Diverted Profits Tax

October 2017

What happened?

The Diverted Profits Tax (DPT) came into effect on 1 July 2017 and 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 or not the particular arrangements were entered into before that time.

The DPT is a 40 per cent rate penalty tax (compared to the normal Australian 30 per cent corporate tax rate), plus interest. A DPT assessment can be issued any time within seven years of the original income tax return assessment. Taxpayers are also 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 aims to ensure that the tax paid by significant global entities (SGEs) properly reflects the economic substance of their activities in Australia and aims to prevent the diversion of profits offshore through arrangements involving related parties. It also encourages SGEs to provide sufficient information to the ATO to allow for the timely resolution of tax disputes.

An entity is an SGE for an income year if it is:

- A global parent entity with an annual global income of A\$1 billion (approximately US\$775M) or more (e.g. Australian-headquartered entities with foreign operations); or
- A member of a group of entities (consolidated for accounting purposes) where the global parent entity has an annual global income of A\$1 billion or more. (e.g. the local operations of foreign headquartered multinationals)

The Government has stated that the DPT is only intended to be applied by the ATO in very limited circumstances and only after they have given consideration to the ordinary operations, including the usual anti avoidance provisions, of the existing income tax law.

What does this mean for you?

In broad terms, the new Law applies if under the scheme, or in connection with the scheme:

1. A taxpayer ('the relevant taxpayer') has obtained a tax benefit in connection with the scheme in an income year;
2. A foreign entity, that is an associate of the relevant taxpayer, entered into or carried out the scheme or is otherwise connected with the scheme; and
3. The principal purpose, or one of the principal purposes of the scheme, is to obtain an Australian tax benefit or to obtain both an Australian and foreign tax benefit; and

None of the following exceptions apply:

1. The \$25 million income test (i.e. the Australian entity has income of less than \$25 million per year);
2. The sufficient foreign tax test (i.e. there is an increase in foreign tax paid as the result of the diversion of income offshore of 80% or more of the reduced Australian tax liability); or
3. The sufficient economic substance test (i.e. the offshore entity has real economic substance and is not just a vehicle used to facilitate the scheme).

If global financial statements have not been prepared for the global parent entity, the Commissioner may make a determination that based on information available to him, the annual global income of the entity would be A\$1 billion or more for the period.

The broad impact of the DPT comes about because it can apply to any Australian cross-border arrangements, including financing transactions, provided at least one foreign associate taxpayer is involved and total group-wide global income exceeds the threshold.

The DPT adopts a 'principal purpose' test. This is a lower hurdle compared to the 'sole or dominant purpose' test within the existing Australian general anti-avoidance provisions. Importantly, the 'principal purpose' test 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 can be taken into account by the ATO.

Because the DPT is incorporated into Australia's anti-avoidance rules, 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 ATO has undertaken to develop and publish a Law Companion Guide to provide further explanation as to the how the Law will be practically applied but to date this Guide has not yet been issued.

How can Nexia help you?

If you are a SGE that operate in Australia we would appreciate the opportunity to talk to you in more detail about the DPT rules.

Because Nexia is a global accountancy network with offices all over the world, we are well-equipped to handle such multinational tax and disclosure issues.

Please contact us so that we can assist you in complying with these obligations and to help you manage your exposure to risk.

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