

# Diverted Profits Tax

Stick

or

Nudge



*"[Some].... companies have pushed the envelope of reasonableness — they play games, they string us along, they believe we can be stooged. However enough is enough — no more of this"*

*Chris Jordan, Senate Committee on Tax Avoidance, Feb 2016*

*Diverted Profits Tax Announcement*

*May 2016 Budget*

# A Stick or Nudge?

- Applies from first income year commencing on or after 1 July 2017 (including transactions entered into before this date)
- 40% rate and is a separate tax albeit an overlap with normal transfer pricing rules and existing Part IVA
- Will generally apply to arrangements that
  - are reasonably viewed as having a principal purpose to secure a tax reduction
    - “among the most important, prominent, leading, main”
    - “where carried on for a main purpose of obtaining a tax benefit and a main commercial objective, the principal purpose will still be met”
- Carveouts:
  - where the tax rate in the associate is more than 80 per cent of Australia’s rate (ie countries with rates more than 24% are excluded); or
  - if the foreign profit reflects the economic substance of the entities activities; or
  - less than \$25m turnover
- A DPT Assessment will:
  - require payment upfront – no 50/50 payment
  - require information to be provided to the ATO within 12 months to evidence why the assessment should be reduced
  - have no objection rights to ATO
    - must go to Federal Court
    - appeal rights generally restricted to evidence provided to the ATO during the 12 month review period
  - not be an alternative assessment (i.e. can have a TP assessment and DPT assessment) for the same matter
  - not have Mutual Agreement Procedures under treaties operative.

# What countries are in the DPT mix?



Country	Headline Tax rate	Total number of dealings	Total value of dealings (\$m)	% of total value of all dealings	Average value of DPT dealing	% of DPT dealings
British Virgin Islands	0%	170	1,397	0%	8	1%
Bermuda	0%	165	2,374	1%	14	1%
Ireland	13%	320	4,963	2%	16	2%
Hong Kong	17%	1,215	7,970	2%	7	8%
Singapore	17%	2,575	100,403	31%	39	17%
Switzerland	17%	695	15,645	5%	23	5%
United Kingdom	19%	3,240	22,898	7%	7	22%
United States	20%	5,950	41,205	13%	7	40%
Netherlands	21%	485	4,109	1%	8	3%
Chile	23%	65	990	0%	15	0%
<b>Total</b>		<b>14,880</b>	<b>201,954</b>	<b>62%</b>	<b>14</b>	<b>99%</b>

- Based on ATO data practically 8, possibly 10 countries by 2019.
- If US and Netherlands rate reductions eventuate:
  - \$202 billion (62% by value of all related party dealings)
  - Ca 15,000 (53%) by number of all related party dealings
  - Of those in the DPT mix - Singapore, US, UK, Switzerland & HK make up 92% of all transactions by number and 58% by value
- If some US state and local taxes qualify as income tax may remove from DPT net?

Source: ATO 2014 IDS statistics Top 3 countries

# What type of transactions?

International related party dealings	Value (\$m)	Number of dealings	Av dealing size	% of value	% of dealings
Interest - expenditure	18,424	2,930	6	4%	11%
Tangible property - expenditure	139,880	2,674	52	32%	10%
Management and administration services - expenditure	9,167	2,640	3	2%	9%
Tangible property - revenue	90,372	1,901	48	21%	7%
Management and administration services - revenue	6,407	1,865	3	1%	7%
Other - expenditure	5,512	1,865	3	1%	7%
Interest - revenue	4,869	1,502	3	1%	5%
Other - revenue	7,202	1,051	7	2%	4%
Software and information technology services -	3,034	1,015	3	1%	4%
Sales and marketing services - revenue	4,861	878	6	1%	3%
Royalties - deductions	6,103	856	7	1%	3%
Other services - expenditure	4,708	777	6	1%	3%
Technical services- expenditure	4,895	692	7	1%	2%
Other services - revenue	4,799	620	8	1%	2%
Technical services- revenue	3,223	588	5	1%	2%
Logistics - expenditure	4,804	381	13	1%	1%
Tangible property - consideration paid	3,950	283	14	1%	1%
Other financial dealings - expenditure	13,725	254	54	3%	1%
Derivatives - expenditure	23,415	173	135	5%	1%
Derivatives - revenue	21,401	158	135	5%	1%
Other financial dealings - revenue	11,602	154	75	3%	1%
Debt factoring - book value	5,103	12	425	1%	0%
Debt factoring - consideration	4,630	12	386	1%	0%
Other	35,397	4,596	8	8%	16%
<b>Total</b>	<b>437,638</b>	<b>27,901</b>	<b>16</b>	<b>100%</b>	<b>100%</b>

○ By number:

- Interest expense (11%)
- Trading Stock expense (10%)
- Management & admin services (9%)
- Software and IT (4%)
- Sales and Marketing (3%)
- Royalties (3%)

○ By value:

- Trading Stock (53%)
- Interest expense (4%)
- Management fees (3%)

# So how big is the stick?

- About 1,600 taxpayers theoretically covered
  - Groups with greater than \$1 billion turnover
- Only expected to yield \$200m over the forward estimates



# What's has been the UK Experience?

- UK DPT has two limbs - one equivalent to our MAAL and the other our DPT.
  
- September 2017 report on 2016/17 HRMC outcomes
  - 145 DPT notifications received
  - DPT yield was £281 million
  - 14 DPT charging notices - £138m raised.
    - Diageo – £107m of this.
    - 13 others raised on average just over £2m
  - £143m “TP behavioral” changes through HMRC action.
  - Unknown if amounts raised or notifications received are under the Australian MAAL or DPT equivalent – suspect the former?
  
- Total transfer pricing adjustments for 2016/17 doubled to £1,616m (total corporation tax collected was £50billion)
  - Evidence that the DPT nudge is working?
  - Google’s adjustment was £130m covering 10 years to 2015
    - Ironically not under the DPT “Google tax”.

# Some observations

- Nudge more than a stick
- Probably used as a provision of last resort for recalcitrant taxpayers given GAAR panel hearing has at least one non-ATO person?
- Importance of sufficient economic substance test and normal transfer pricing rules and evidence
- Still awaiting finalization of ATO law companion and practical compliance guidelines and practice statement
  - Delay because ATO don't see it as a priority?
- Some major “flags on the beach” have been set, or are about to be set:
  - Related party debt PCG
  - Marketing hubs PCG
  - 5% mark-up on non core intra-group services?

