LCG 2015/2 - Section 177DA of the Income Tax Assessment Act 1936 : schemes that limit a taxable presence in Australia

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Section 177DA of the *Income Tax Assessment Act 1936*: schemes that limit a taxable presence in Australia

Relying on this Guideline

This publication is a public ruling for the purposes of the *Taxation Administration Act 1953*.

This Guideline describes how the Commissioner will apply the law as amended by Schedule 2 to the *Tax Laws Amendment (Combating Multinational Tax Avoidance) Act 2015* to entities that rely on this Guideline in good faith.

If you rely on this Guideline in good faith, you will not have to pay any underpaid tax, penalties or interest in respect of matters covered by the Guideline if it does not correctly state how a relevant provision applies to you.

[**Note:** This is a consolidated version of this document. Refer to the Legal Database (https://www.ato.gov.au/Law/) to check its currency and to view the details of all changes.]

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What this Guideline is about

1. This Guideline discusses *Tax Laws Amendment (Combating Multinational Tax Avoidance) Act 2015* (the Act), in particular, Schedule 2 to the Act which deals with schemes that limit a taxable presence in Australia. This Guideline is provided as a measure to assist you with understanding the law.

Early engagement

2. We would like to work closely with those taxpayers who are likely impacted by the multinational anti–avoidance law (MAAL) to provide greater certainty with the new law.

3. In this regard, our immediate focus is on assisting taxpayers to determine whether they fall within the scope of the new provisions, as well as working closely with those taxpayers who may be restructuring their operations in light of the provisions. We have developed an internal framework for transitional arrangements for the MAAL, including a client experience road-map.

4. The ATO would like to initiate an early dialogue with all taxpayers who may fall within the ambit of the MAAL. Accordingly, if you have considered the below guidance, examples and framing questions and consider that the MAAL may apply, we are happy to answer queries should you wish to discuss your circumstances (including restructuring arrangements) or if you are unsure if the MAAL applies to your arrangements / structure. The key point of contact, should you wish to discuss further, is the MAAL project team via: MAAL@ato.gov.au.

5. Miscellaneous Taxation Ruling MT 2012/3 *Administrative penalties: voluntary disclosures* sets out the circumstances in which the Commissioner is able to remit penalties in the case of voluntary disclosures.

Outline of the new law

6. The MAAL is designed to counter the erosion of the Australian tax base by multinational entities using artificial and contrived arrangements to avoid the attribution of profits to a permanent establishment in Australia.

7. Schedule 2 to the Act amends the anti-avoidance provisions in Part IVA of the *Income Tax* Assessment *Act 1936* (ITAA 1936)[1] to introduce section 177DA, also referred to as the MAAL.

[1] All legislative references in this guideline are to the ITAA 1936, unless otherwise stated.

8. Under section 177DA, a taxpayer may have their tax benefit cancelled by the Commissioner under Part IVA if they:

- are a significant global entity (an entity with annual global income, or the annual global income of the group in which the entity is a member, is $1 billion or more), and they
- obtain a tax benefit in connection with a scheme (involving the avoidance of the attribution of income to an Australian permanent establishment) that was entered into or carried out for a principal purpose of, or for more than one principal purpose that includes a purpose of obtaining a tax benefit (or obtaining both a tax benefit and reducing a foreign tax liability) under the scheme.

Necessary conditions for the MAAL to apply

9. In order for the MAAL to apply to a foreign entity **all** of the following conditions must be satisfied:

- the foreign entity is a 'significant global entity'
- there is a scheme with the following features:
  - the foreign entity makes supplies to customers in Australia
  - activities are undertaken in Australia directly in connection with those supplies by an Australian entity who is associated or commercially dependent on the foreign entity
  - the foreign entity derives ordinary or statutory income from those supplies, some or all of which, is not attributable to a permanent establishment in Australia of the foreign entity, and
- a person who entered into or carried out the scheme did so for a principal purpose of, or for more than one principal purpose that includes a purpose of:
  - enabling a taxpayer to obtain a tax benefit in Australia, or also to reduce one or more of their foreign tax liabilities, or
  - enabling a taxpayer and another taxpayer to each obtain tax benefits in Australia, or also to reduce either of their foreign tax liabilities.

When the MAAL does not apply

10. The MAAL will not apply in **any** of the following circumstances:

- An entity does not satisfy the 'significant global entity' requirement explained above.
- An entity sells directly to customers in Australia, and no activities are undertaken in Australia by an associate or commercially dependent entity that are in direct connection with those supplies (for example, this would be the case where there is no such related entity physically present in Australia, or there is such an entity in Australia but all of their activities relate to post-contract customer issues such as faulty products and delivery delays issues).
- An entity only makes excluded supplies to customers in Australia (that is, the supply of an equity interest or a debt interest in an entity, or the supply of an option to supply either or a combination of such types of interests).
- An entity does not derive ordinary or statutory income from the supplies it makes to customers in Australia.
- None of the persons who entered into or carried out a scheme, or any part of a scheme, to which paragraph 177DA(1)(a) applies has the requisite principal purpose (see below for further explanation of the principal purpose test).

Specific issues for guidance

Principal purpose test

11. Section 177DA has a lower threshold test than the 'sole or dominant' purpose test in existing section 177D. The threshold for the purpose test in section 177DA is '… a principal purpose of, or for more than one principal purpose that includes a purpose of…'.

12. 'Principal' is not defined in the Act. The *Macquarie Dictionary* defines principal as '1. first or highest in rank, importance, value, etc.; chief; foremost.'. The *Oxford English Dictionary* defines 'principal' as '1. Of a number of things or persons, or one of their number: belonging to the first rank; among the most important; prominent, leading, main'. This can be compared to 'dominant' which is defined as 'ruling; governing; controlling; most influential…main; major; chief' (*Macquarie Dictionary*) and 'ruling, governing, commanding; most influential' (*Oxford English Dictionary*).

13. In using the language 'or for more than one principal purpose' it is clear that Parliament intended there to be more than one possible principal purpose for entering into the scheme. Therefore, in this context, 'principal' does not mean strictly 'first or highest in rank', but rather 'among the most important, prominent, leading, main'.

14. One critical difference between the principal purpose test in paragraph 177DA(1)(b) and the sole or dominant test in existing subsection 177D(1) is that the test in 177DA(1)(b) is not whether '**the'** principal purpose was to obtain a tax benefit (or to also reduce a liability to foreign tax). Rather, the test allows for a number of principal purposes and looks to whether one of those principal purposes was to obtain a tax benefit (or to also reduce a liability to foreign tax). Accordingly, it does not have to be the main purpose, just one of the main purposes for entering into the scheme. This means that where a person who entered into or carried out a scheme has a main purpose of obtaining a tax benefit and also has a main purpose of achieving a particular commercial objective, the principal purpose test will still be met in relation to that scheme, without the need to determine which of the main purposes is the dominant purpose.

15. The intention, as explained in the Explanatory Memorandum to the Tax Laws Amendment (Combating Multinational Tax Avoidance) Bill 2015 (Explanatory Memorandum), is for this test to be consistent with the approach to be taken internationally through the OECD Base Erosion and Profit Shifting (BEPS) work on Action 6 (Preventing the granting of treaty benefits in inappropriate circumstances). The OECD Report on Action 6, published on 5 October 2015, recommends new OECD Model provisions, one of which involves a principal purpose test that adopts the words '… one of the principal purposes …'. Given the similarity in wording and the statements in the Explanatory Memorandum, the ATO considers the proposed Commentary to the OECD Model on the principal purpose test is relevant guidance on the meaning of '… a principal purpose of, or for more than one principal purpose that includes a purpose of…' in section 177DA.

16. For example, consistent with the proposed OECD Model Commentary (in particular see pages 57 and 58 of the OECD Report on Action 6), we consider that:

- where the particular form in which the scheme is implemented is more reasonably explained by the tax benefit obtained (or combined with any reduction in a foreign tax liability) then we may conclude that one of the principal purposes of the scheme was to obtain that benefit, and
- where the scheme is inextricably linked to a core commercial activity and the particular form in which the scheme is implemented is conventional and straightforward and not driven by such tax benefit considerations, then it is unlikely that one of its principal purposes was to obtain the tax benefit.

Timing

17. The test in paragraph 177DA(1)(b) makes it clear that the purpose of a person can be determined both at the time the scheme is entered into and when it is carried out. This is also consistent with the matters that the Commissioner must have regard to in determining purpose (see subsection 177DA(2)), which involves considering aspects relating to how the scheme was entered into, and aspects relating to how the scheme was carried out (the relevant matters are referred to further below).

A combined purpose of obtaining a tax benefit and reducing (or deferring) a liability to tax under a foreign law

18. The purpose test in section 177DA captures schemes designed to obtain:

- a tax benefit under Australian income tax law, or
- both a tax benefit under Australian income tax law, and a reduction in (or deferral of) a foreign tax liability.

19. Therefore, in circumstances where:

- a foreign entity is considered to have obtained a tax benefit in relation to a scheme by avoiding having their income from supplies to Australian customers being attributable to a permanent establishment in Australia, and
- that same entity or another foreign entity is considered to have reduced (or deferred) their liability to foreign tax as part of that scheme,

these two purposes can be combined and considered together to determine whether the combined purpose was a principal purpose of the person, or more of the persons, who entered into or carried out the scheme, or any part of the scheme.

20. In determining whether a purpose (whether it be a single or combined purpose) is a principal purpose, the Commissioner will consider the eight matters in subsection 177D(2), and the two additional matters in paragraphs subsection 177DA(2)(b) and (c).

21. There may be circumstances where a foreign entity has reduced their liability to foreign tax in connection with the scheme, but is still subject to some level of foreign tax, or the foreign entity may undertake activities in the foreign jurisdiction that are commensurate with the income they report or allocate to that jurisdiction. For example, a foreign entity may obtain a reduced or nil rate of corporate tax in a foreign jurisdiction for a set period of time because they are undertaking a certain type of commercial activity in that jurisdiction.

22. Facts such as these will not alone determine whether there is the requisite principal purpose. Each of the ten matters must be considered. For example, the above facts would be considered by the Commissioner when having regard to the following matters:

- the manner in which the scheme has been entered into
- form and substance of the scheme, and
- the result, in relation to the operation of any foreign law relating to taxation, that (but for Part IVA) would be achieved by the scheme.

A reduction or deferral of foreign tax liabilities

23. Any reduction of a liability to tax under a foreign law is relevant in considering the purpose test in section 177DA. Consistent with the Explanatory Memorandum, in determining what would be a 'tax under a foreign law' the Commissioner would consider any foreign taxes, and this would extend beyond income tax liabilities, and would include both national and sub-national foreign laws.

24. Under section 177DA, a deferral of a taxpayer's liabilities to tax under a foreign law is taken to be a reduction of liabilities. A deferral, however, is not taken to be a reduction of those liabilities where there are reasonable commercial grounds for the deferral.

25. In determining whether a taxpayer has reasonable commercial grounds for the deferral of their liability to tax under a foreign law, the Commissioner will consider:

- the length of the deferral, for example, the length of time the income is held by an entity in a global group of entities before it is repatriated to another group member who is subject to tax on the income, and whether the period of deferral would reasonably be expected to occur between two entities who are not part of the same global group of entities
- whether compliance with any legal, including prudential regulatory, requirements under a foreign law results in delays in repatriation of funds within a global group of entities
- any contractual or administrative reasons that may cause short-term delays in repatriation of funds within a global group of entities
- the past pattern of repatriation decisions within a global group, and
- whether the delay in repatriation is due to a repatriation decision that is yet to be made or a decision to declare a dividend is yet to be made.

Determining the tax benefit for schemes captured by the measure

26. It is necessary to identify the tax benefit obtained in connection with the scheme for the purposes of section 177C. This involves the Commissioner identifying a postulate that is a reasonable alternative to the actual scheme (subsection 177CB(3)). Alternatively, it might involve simply assuming the scheme away (subsection 177CB(2)). But, as that is unlikely to result in a tax benefit in the typical case against which section 177DA is aimed, it is usually necessary to hypothesise that steps would have been taken in Australia that would lead to the existence of a permanent establishment in Australia.

27. A reasonable alternative to a scheme captured by section 177DA typically includes supplies to Australian customers being made by the foreign entity through its Australian permanent establishment (a notional permanent establishment). The scope of the notional permanent establishment will depend on the facts and circumstances of the case. Typically, the scope of the notional permanent establishment will include all of the activities of the Australian-based entity who contributes to bringing about the contract for the supply as well as the functions, assets and risks of the foreign entity that are associated with formally concluding the contracts where the reasonable alternative to the scheme involves the Australian based entity signing the contracts on behalf of the foreign entity. The scope of the notional permanent establishment will depend on what is the reasonable alternate postulate. The fact that the functions or assets of the foreign entity may be located offshore does not necessarily mean that those functions and assets cannot be within the scope of the notional permanent establishment.

28. Two tax benefits that are likely to be obtained under schemes captured by section 177DA are:

- an amount not being included in the assessable income of a taxpayer, and
- a taxpayer not being liable to withholding tax.

Attributing profit

29. Applying section 177DA therefore involves determining what profits would have been attributable to the notional permanent establishment in Australia. That is, determining what amount would be expected to have been included in the notional permanent establishment's assessable income if the scheme had not been entered into or carried out. This requires identifying what amounts of gross income would have been included in the taxpayer's assessable income under the reasonable alternative to the scheme. As expenses are not a relevant factor in this initial process of determining assessable income, the expenses incurred by the foreign entity that are attributed to the notional permanent establishment are not taken into account in determining the amount of the tax benefit. However, a compensating adjustment may be provided under subsection 177F(3) where the Commissioner considers it fair and reasonable to do so. Compensating adjustments are discussed in the section following.

30. The normal attribution process under the relevant treaty or under Subdivision 815-C of the *Income Tax Assessment Act 1997* (ITAA 1997) applies in respect to the notional permanent establishment. For example, in accordance with Taxation Ruling TR 2001/11, it will be necessary to identify the economically significant activities of the foreign entity and the role the notional permanent establishment plays in those activities, as well as the assets used and the risks assumed by the notional permanent establishment.

31. It is not necessarily the case that all of the gross income from sales to Australian customers will be attributed to the notional permanent establishment, it will depend on the extent to which the notional permanent establishment contributes to the economically significant activities of the foreign entity, as compared to the contribution made, if any, by the rest of foreign entity. For example, in circumstances where the rest of the foreign entity makes modifications to the physical product that is supplied to Australian customers to cater for individual customer's requirements, that function would be recognised and rewarded to the rest of the foreign entity under the attribution process and accordingly not all of the income from sales to Australian customers would be attributed to the notional permanent establishment.

Taxation obligations

32. Following the normal attribution process for a notional permanent establishment, it would also be necessary to consider any obligations under the tax law. For example, consideration would need to be given to any withholding tax obligations arising in respect of the notional Australian permanent establishment. This may be relevant, for example, if a royalty is derived by a non-resident and paid to a non-resident by a person who is not a resident. There would be a withholding tax liability if such an outgoing is (or is in part) an outgoing incurred by that person in carrying on a business at or through the notional permanent establishment in Australia.

33. Under subsection 4(2) of the *International Tax Agreement Act 1953* the application of Part IVA is not restricted by Australia's tax treaties, which otherwise take precedence over Australia's domestic tax laws. This preservation of the application of Part IVA in a treaty context is explained to Australia's treaty partners during tax treaty negotiations and is also explained at paragraph 6 of Taxation Ruling TR 2001/13.

Compensating adjustments

34. Under subsection 177F(1), the Commissioner may make a determination that effectively cancels a tax benefit obtained by a taxpayer, for example, by including an amount in the assessable income of the taxpayer. In such circumstances, under subsection 177F(3), the Commissioner may also make a compensating adjustment that effectively reduces the amount of the tax benefit cancelled where, in the opinion of the Commissioner, it would be fair and reasonable to do so.

35. Every request for a compensating adjustment needs to be decided on its own merits having regard to the facts and circumstances of the case. Generally speaking however, it would be considered fair and reasonable for the Commissioner to provide a compensating adjustment for a deduction that would otherwise be allowable to the taxpayer had the scheme not been entered into, for example, for a royalty expense attributable to a notional permanent establishment where the relevant royalty withholding tax has ultimately been paid. However, and again speaking generally, it would on the face of it not be considered fair and reasonable for the Commissioner to provide a compensating adjustment for taxes paid in a foreign country by the foreign entity in relation to assessable income forming part of a tax benefit under a scheme to which section 177DA applies.

36. This is because the foreign entity in such circumstances would:

(i) not otherwise be entitled to a foreign income tax offset under Division 770 of the ITAA 1997 had the scheme not been entered into (as it is not a resident of Australia and the income is from sources in Australia), and

(ii) not be entitled to seek relief from Australia for any double taxation under the relevant tax treaty, because it is the country of residence of the foreign entity that is obliged to provide relief under a tax treaty in such circumstances.

37. The foreign entity would need to seek relief from any double taxation from their country of residence. If that country does not consider it is obliged to provide such relief under the relevant tax treaty the taxpayer can seek to resolve the double taxation in accordance with the Mutual Agreement Procedure under the relevant tax treaty.

Examples

38. The two examples below set out two scenarios at each end of the 'risk spectrum' for the MAAL. In one of these scenarios (the 'High risk example'), in the Commissioner's view the hypothetical circumstances are illustrative of an arrangement where there is a strong likelihood that the MAAL would apply. In the other scenario (the 'Low risk example'), in the Commissioner's view the hypothetical circumstances are illustrative of an arrangement where there is a strong likelihood that the MAAL would not apply. The two scenarios are designed to highlight different aspects of the key threshold tests in relation to the concepts of 'principal purpose' and 'tax benefit'.

39. These scenarios are then supplemented by a series of 'Framing questions'. These framing questions highlight issues the Commissioner views as important considerations in determining whether or not the MAAL is likely to apply, having regard to the threshold tests in relation to the existence of a scheme, principal purpose and tax benefit.

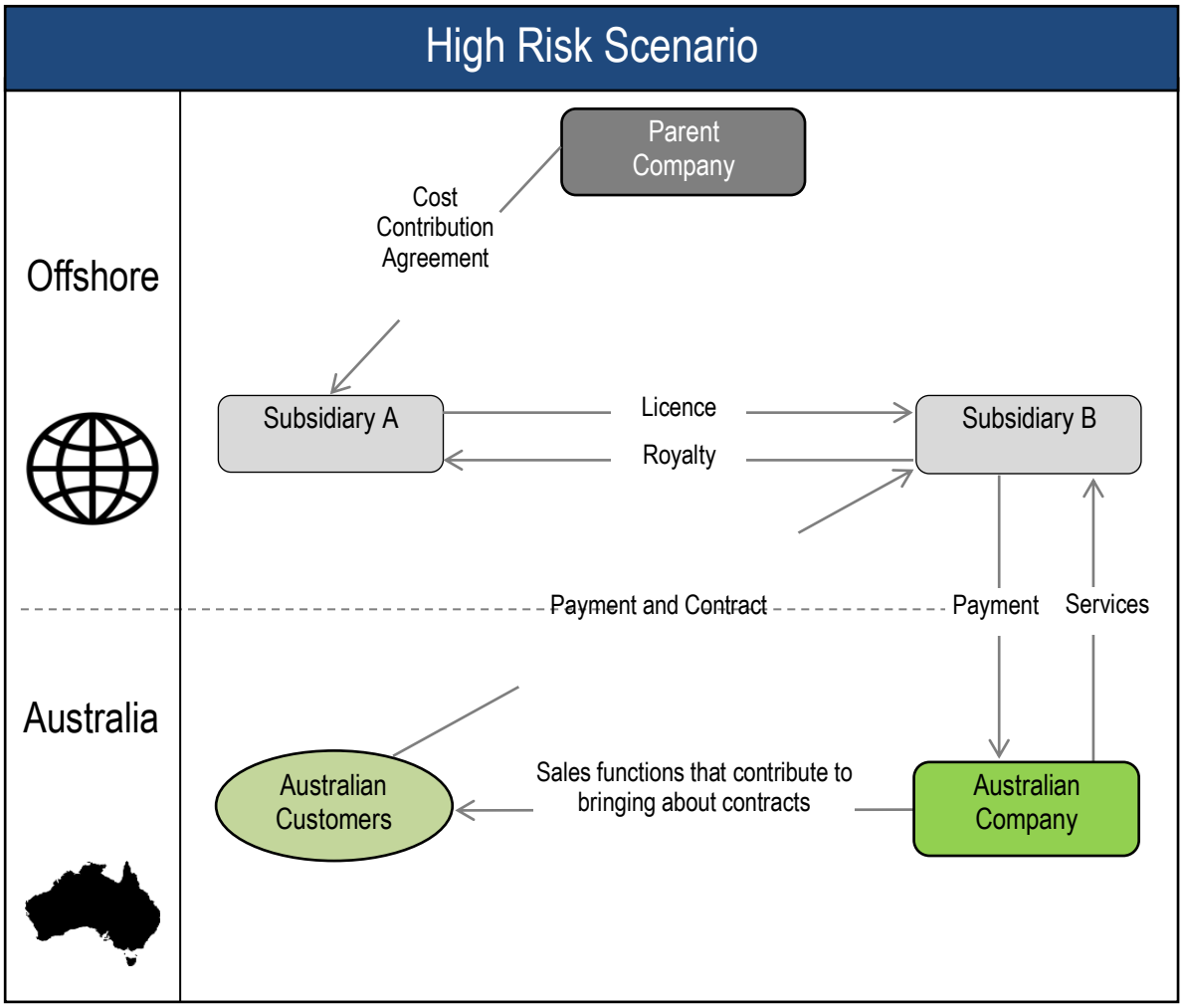
40. In line with Example 3.1 of the Explanatory Memorandum, if a foreign entity sells goods to its Australian subsidiary, who in turn sells goods to unrelated Australian customers, the MAAL will not apply. Taxpayers who facilitate their arrangements in this manner will not need to consider the application of MAAL (including the below scenarios and framing questions).

Background

41. The preconditions for application of the MAAL include (but are not limited to) that for 'significant global entities', the MAAL will apply to a scheme if under, or in connection with, the scheme a foreign entity makes a supply to an Australian customer and activities are undertaken in Australia directly in connection with the supply. Further, that the scheme is entered into for a 'principal purpose' of (or for more than one 'principal purpose' that includes a purpose of) enabling a taxpayer to obtain a tax benefit or both to obtain a tax benefit and to reduce one or more foreign tax liabilities.

42. In the hypothetical circumstances outlined, the examples highlight characteristics that the Commissioner considers may be relevant to an evaluation of the applicability of the provision. These include questions arising in relation to 'supply', 'activities undertaken in connection with the supply', 'principal purpose(s)' and 'tax benefit'.

High risk example



43. The parent entity for the multinational group owns the intellectual property and the respective rights. The parent entity's consolidated accounts indicate annual global income for the group that is well in excess of A$1 billion. The parent entity has entered into a cost sharing agreement with a subsidiary in a jurisdiction where no income tax is levied and which does not have intellectual property protection laws ('Sub A'). Sub A's contribution to the cost sharing agreement is cash, and all the decisions regarding the ongoing development of the intellectual property are made in the parent entity's home jurisdiction. Sub A sub-licences its rights to another subsidiary ('Sub B') in a jurisdiction which has agreed to provide it with a lower tax rate than its headline corporate tax rate. Sub B pays a royalty to Sub A for access to Sub A's intellectual property rights. The royalty is calculated on territorial sales, including Australian sales. Revenue from Australian customers is returned by Sub B.

44. Sub A has no employees. Sub B has 20 employees who manage all the Asia Pacific sales and also engages third party contractors.

45. Sales of the tangible product and related services to Australian customers are made directly by Sub B through several channels. Sub B sells to various third party/unrelated partners who are authorised to re-sell the product (channel partners). Sub B also sells directly to corporate customers. Channel partners sell to smaller resellers and retailers who then on sell to end customers. Corporate customers are required to contract with Sub B directly.

46. An Australian subsidiary who is a member of the multinational group does not itself make any sales in Australia. The Australian subsidiary has 50 employees and provides support and services to the various types of customers in Australia. The Australian subsidiary has a role in identifying the channel partners authorised to re-sell products, but the formal decision to engage them is taken by Sub B. Australian staff also meets with channel partners from time to time to support their business and convey any key corporate messages from Sub B via the parent entity. Sales teams within the Australian subsidiary work with corporate customers to renew their existing contracts or engage in mid-cycle selling with customers to upsell into higher value products and buy add-ons. Australian staff sometimes also assists channel partners in placing orders through the automated ordering process for the group. The Australian subsidiary's operating costs are reimbursed by Sub B (including a mark-up on these costs).

47. Once a channel partner or corporate customer contract is ready for signing, the Australian staff directs them to submit the contract through an electronic portal for Sub B to sign.

Conclusion

48. This hypothetical scenario highlights a fact pattern that suggests 'high risk' in terms of likely application of the MAAL. It would appear that the preconditions for the existence of a scheme under the MAAL are met. It would be necessary for a Group in the same or similar circumstances as those outlined to consider factors relevant to the principal purpose of the scheme and whether they have obtained a tax benefit in connection with the scheme.

49. In particular this would include the fact that the activities of the Australian subsidiary (an associate of the parent entity) contribute to bringing about the contract for the supply to Australian customers directly and through the channel partners, and to renewing (and adjusting) existing contracts with Australian customers. A Group in the same or similar circumstances will need to consider whether a reasonable alternative postulate to this arrangement would be that a member of the Group would have included an amount in their assessable income in Australia because they would have had business profits attributed to a permanent establishment in Australia (and whether withholding tax would have also been payable on the royalty payments incurred in carrying on business in Australia at or through that notional permanent establishment in Australia).

50. Also relevant to the principal purpose of the scheme is the sub-licencing of the intellectual property rights to a jurisdiction providing a tax rate lower than its headline corporate tax rate, with the royalty in respect of the sub-licence calculated on territorial sales (including Australian sales) paid to a jurisdiction where no income tax is levied. In comparing the scheme to alternative possibilities that existed, a Group in the same or similar circumstances will also need to consider whether a member of the group has reduced their liability to tax under a foreign law as result of the scheme. For example, under this hypothetical scenario a reasonable alternative may involve the parent entity, Sub A or Sub B being liable to pay more tax under a foreign law (whether on a greater amount of income or at a higher rate of tax than the rate paid by Sub B under the scheme).

51. A Group in the same or similar circumstances may have commercial reasons for structuring their global business in such a manner. For example, the parent entity in the hypothetical scenario may argue that Sub B was established primarily to centralise management functions to improve management practices and reduce corporate risk and not to obtain tax advantages. The parent entity may also argue that because Sub B pays tax in that jurisdiction they do not have a purpose of reducing their foreign tax. While the Commissioner will take these commercial reasons for the location of Sub B into account, as explained above, the Commissioner will consider all ten matters referred to in subsection 177DA(2). However, the fact that some foreign tax is paid by a member of the group does not necessarily mean there is no purpose of reducing a foreign tax liability.

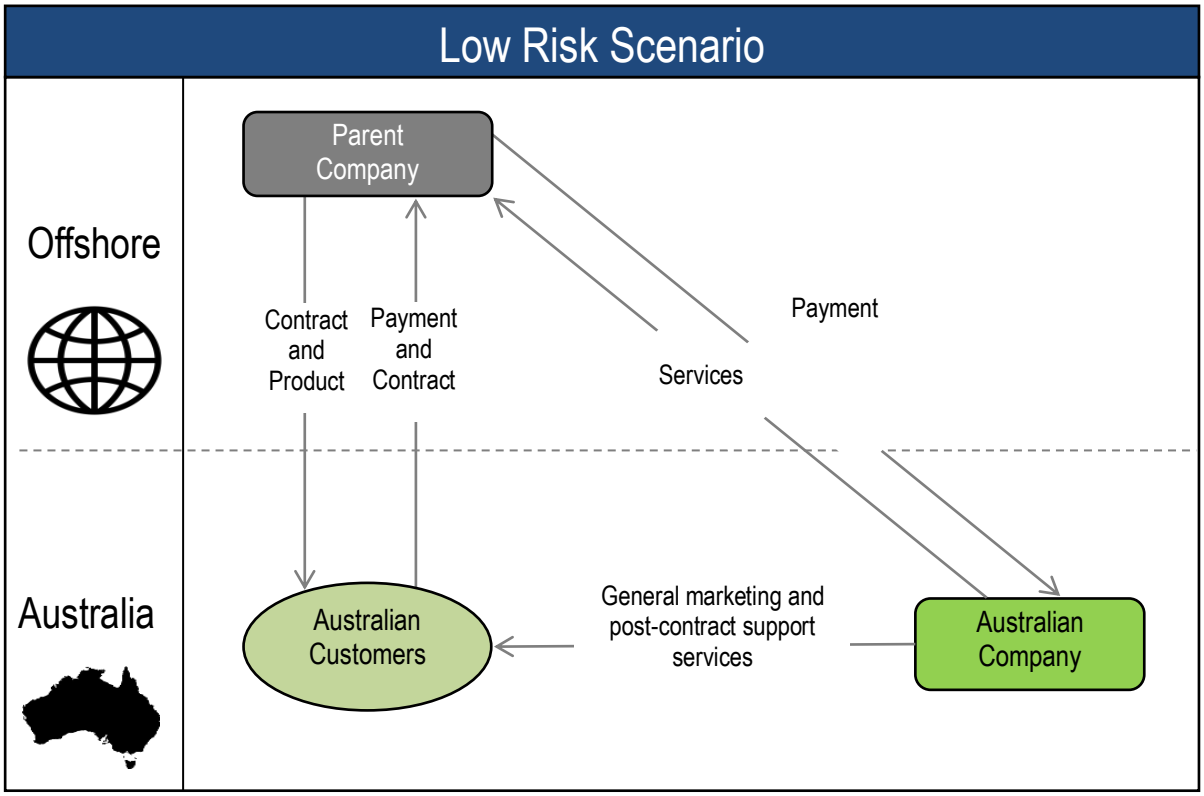
52. Taking all of these matters into account, in this hypothetical scenario it is highly likely there is the requisite principal purpose given:

- the combined Australian tax benefits and the reduction in the foreign tax liabilities
- a comparison of the form and substance of the scheme, including the fact that Sub A has no employees and does not contribute to the ongoing development of the Group's intellectual property, and
- the Australian subsidiary (not Sub B) undertakes most of the activities necessary to bring about contracts with Australian customers.

The consequences of a conclusion as to principal purpose will include, as noted above:

- determining the tax benefit and its amount for the scheme, which involves income tax (including profit attribution) and withholding tax issues, and
- determining appropriate compensating adjustments.

Low risk example



53. The parent entity for the multinational group (ParentCo) is the legal owner of certain intellectual property and the respective rights that go with that intellectual property. The intellectual property in question is economically significant in the context of the global group's operations. The parent entity's consolidated accounts indicate annual global income for the group that is well in excess of A$1 billion. ParentCo's employees (located in ParentCo's tax jurisdiction) are responsible for:

- planning and managing the research to maintain and improve the value created by the core intellectual property
- coordinating all intellectual property registration and protection for the group worldwide
- coordinating all manufacturing, done by third party manufacturers, on behalf of the group worldwide, and

- purchasing of third party products, which it sells additionally to its own branded products through its website.

54. ParentCo sells its products directly to Australian customers. Australian customers are redirected to an Australian version of the website due to their IP and/or billing address. The Australian version of the IP website is updated and controlled by the marketing and Information Technology staff employed by ParentCo and who are located in ParentCo's tax jurisdiction. These same staff are responsible for undertaking this function for all country websites.

55. Once the Australian customer has selected their intended products, they pay via credit card or through another online payment provider. The order is then shipped from a warehouse owned by ParentCo, located in ParentCo's tax jurisdiction. The order is sent via a third party international courier.

56. Given the growing size of the Australian market, the company employs 20 Australian staff in an Australian subsidiary (AusCo). The dealings between ParentCo and AusCo are formalised by way of inter-company agreements which specify respective roles and responsibilities in relation to sales and marketing, and support services. As per these agreements, AusCo is remunerated for its economic contribution based on a percentage-based commission on Australian territorial sales. Five of these staff are responsible for coordinating advertising and marketing campaigns in Australia through print, television and online media. The marketing campaigns for Australia are part of larger global campaigns developed by ParentCo's marketing staff. Any of this material that is designed or altered for the Australian market is approved by staff in ParentCo prior to it being delivered. AusCo's marketing staff have regular virtual meetings with the marketing staff in ParentCo to discuss the success of marketing and advertising campaigns in Australia.

57. The majority of remaining AusCo staff are responsible for providing low level 'back office' support services for Australian customers, including:

- password, login and payment issues
- post-sale issues with orders, for example, delivery delays, faulty products, and
- coordinating and booking pick-ups for customer returns, where a third party international courier has been engaged by the parent to provide logistics services.

58. The Australian staff are provided with a trouble-shooting database as well as access to the customer's account details. Both of these databases are updated and maintained by staff employed by ParentCo. AusCo staff cannot alter orders placed by customers or process payments over the phone on behalf of ParentCo.

Conclusion

59. This hypothetical scenario highlights a fact pattern that suggests 'low risk' in terms of likely application of the MAAL. While preconditions for the existence of a scheme appear to be met, it is not clear that factors relevant to establishing the existence of a tax benefit or a principal purpose in relation to a tax benefit are present. In particular, the staff of the Australian subsidiary do not contribute to bringing about the contracts for the supply of products to customers in Australia.

60. These staff members do not have any contact with customers in Australia before they order products online from ParentCo. Accordingly, it would be unlikely that a reasonable alternative to this arrangement would be that the Australian subsidiary would have negotiated and concluded contracts with Australian customers on behalf of ParentCo, such that the Australian subsidiary would have been a dependent agent permanent establishment of ParentCo in Australia.

Framing questions

61. There are several steps relevant to an assessment of whether or not entities need to consider the application of the MAAL. The application of the MAAL to your situation will depend on the specific facts and circumstances of your cases. However, set out below are a series of questions you may want to consider in assessing the application of the MAAL with respect to:

- direct connection under subparagraph 177DA(1)(a)(ii)
- commercially dependent under subparagraph 177DA(1)(a)(iii), and
- purpose of the scheme under paragraph 177DA(1)(b)

Direct connection

Are there any activities undertaken in Australia 'directly in connection' with the supply to customers in Australia?

For convenience such supplies are referred to below as 'Australian sales' and includes, among other things the supply of goods or services, including electronic material, advertising services, downloads, the provision of data, intellectual property rights and the right to priority search functions.

Factors to consider:

- *The nature of the activities undertaken in Australia in relation to the Australian sales.*
- *The extent to which the Australian entity (subsidiary or Australian permanent establishment) staff are responsible for contractual and commercial negotiations with Australian customers.*
- *The level (if any) of day to day contact between Australian staff and the Australian customers.*

Commercially dependent

Are any of these activities undertaken by an Australian entity (subsidiary or Australian permanent establishment) that is an associate of, or 'commercially dependent', on the foreign entity?

Factors to consider:

- *Whether the foreign entity sells direct to Australian customers through truly independent Australian sales agents.*
- *Whether there are related Australian entities involved in some aspect of the sales process.*
- *The nature of the relationship between the foreign entity and the Australian entity undertaking activities connected to the Australian sales.*
- *If the foreign entity and the Australian entity are not connected, whether the otherwise independent Australian entity would remain a viable 'going concern' without its dealings with the foreign entity.*

Purpose of the scheme

'No' answers to the following questions indicate a lower likelihood of the MAAL applying.

Is there a discrepancy between the form of the scheme and the commercial and economic substance of the scheme?

Factors to consider:

- *Do the contractual rights and obligations differ from the economic and commercial reality?*
- *Does the scheme involve any aspect that appears artificial, contrived or that could be undertaken in a more straightforward manner?*
- *Are there any aspects of the scheme that would not be expected to be seen in ordinary business dealings between unrelated parties?*
- *Are there entities in the scheme that commercially bear risks that do not align with the legal allocation of those risks? (This involves considering who has the capacity and personnel to manage and control the risk.)*

To what extent are the activities that contribute to bringing about the contract for the supply undertaken by an associated or commercially dependent entity (or a permanent establishment of such an entity) in Australia (an 'Australian based entity')?

Factors to consider:

- *Are the activities in relation to bringing about the contract for the supply predominantly performed by the Australian based entity?*
  - *Where commercial and contractual negotiations are needed, are staff of the Australian based entity directly involved in these negotiations with Australian customers?*
  - *Does the foreign entity not have the requisite personnel and commercial capacity (including staff with the relevant qualifications to undertake the requisite functions, financial and otherwise) to carry out the activities needed to obtain the contracts?*
  - *Are the activities performed by the staff of the foreign entity in relation to bringing about the contract for the supply predominantly routine clerical and administrative activities?*
  - *Have the activities undertaken by the foreign entity and the Australian based entity been split in a such a way so as to avoid the foreign entity having a permanent establishment in Australia?*
  - *Do staff from the foreign entity rarely have any direct communication with customers in Australia in relation to the contract or the supply?*
  - *Does the Australian based entity provide significant levels of support to customers in Australia in order to bring the customer to a positon where the customer is ready to enter into a contract with the foreign entity?*

Has any entity connected with the scheme reduced its liability to tax under a foreign law as a result of the scheme?

Factors to consider:

- *Is the income from sales to Australian customers not subject to tax in the country of residence of the foreign entity?*

- *Does the foreign entity receive a tax concession (corporate or otherwise) under a foreign law that reduces taxation on the income from sales to Australian customers?*
- *Does the foreign entity make related party payments to other members of the global group that relate to the income from Australian sales, which are not taxed (or taxed at a concessional rate) in the hands of the member of the group that receives them?*
- *Does the scheme involve transactions that result in a reduction in tax due to the operation of a foreign tax law or a tax treaty?*

If foreign tax is paid by any member of the global group in relation to the income from Australian sales, is the rate of foreign tax paid lower than Australia's corporate rate of taxation?

Documentation

62. There is no specific record keeping requirements in the MAAL. Taxpayers will need to keep appropriate records of their arrangements and transactions in the normal way.

Status of existing Advance Pricing Agreements

63. If you need to consider whether MAAL applies to a structure/transaction which is covered by an existing Advance Pricing Agreements, then you can also contact the MAAL project team at MAAL@ato.gov.au.

ATO approach to managing tax risk

64. Australia's largest businesses expect and receive customised service from us. Our interactions with public and international groups are tailored based on company size, complexity and behaviour. Our focus is on prevention before correction, and providing early assurance to taxpayers. For further information on how the ATO manages tax risk, refer to the Large Business Active Compliance Manual and Building confidence on the ATO website.

Related guidance products

65. Other guidance material that has been issued by the Commissioner that may be relevant to the application of section 177DA include:

- PS LA 2005/24 which deals with the existing provisions of Part IVA. It is noted that this practice statement is currently under review and a revised draft PSLA was issued for consultation on 13 August 2015 as PS LA 2005/24 (draft).
- TR 2001/11 which deals with the attribution of profit to permanent establishments.
- PS LA 2012/5 which deals with the imposition of penalties and the grounds for their remission.
- PS LA 2011/30 which deals with remission of penalties relating to scheme shortfall amounts.
- MT 2012/3 which deals with administrative penalties in the case of voluntary disclosures.

Further guidance

66. As noted above, the ATO has developed an internal framework for transitional arrangements for the MAAL, including a client experience road-map. Note that this road-map does not form part of this binding public ruling. A copy of the client experience road-map can also be obtained by contacting the MAAL project team at MAAL@ato.gov.au.

Commissioner of Taxation
11 December 2015

References

ATOlaw topic(s)	Tax integrity measures ~~ Part IVA ~~ General anti-avoidance rules Tax integrity measures ~~ OECD issues
Legislative references	ITAA 1936 ITAA 1936 Pt IVA ITAA 1936 177C ITAA 1936 177CB(2) ITAA 1936 177CB(3) ITAA 1936 177D(1) ITAA 1936 177D(2) ITAA 1936 177DA ITAA 1936 177DA(1)(a) ITAA 1936 177DA(1)(a)(ii) ITAA 1936 177DA(1)(a)(iii) ITAA 1936 177DA(1)(b) ITAA 1936 177DA(2) ITAA 1936 177DA(2)(b) ITAA 1936 177DA(2)(c) ITAA 1936 177F(1) ITAA 1936 177F(3) ITAA 1997 Div 770 ITAA 1997 Subdiv 815-C Tax Laws Amendment (Combating Multinational Tax Avoidance) Act 2015 Tax Laws Amendment (Combating Multinational Tax Avoidance) Act 2015 Sch 2 ITAA 1953 4(2) TAA 1953
Related Rulings/Determinations	TR 2001/11 TR 2001/13 MT 2012/3
Other references	Explanatory Memorandum to the Tax Laws Amendment (Combating Multinational Tax Avoidance) Bill 2015 The OECD Report on Action 6 PS LA 2005/24 PS LA 2011/30 PS LA 2012/5 Macquarie Dictionary Oxford English Dictionary

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