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Diverted Profits Tax Exposure Draft Legislation

Thank you for the opportunity to provide our comments on the diverted profits tax (DPT) exposure draft legislation (ED).

The Property Council is the peak body for owners and investors in Australia's $670 billion property investment industry. We represent, owners, fund managers, superannuation trusts developers and investors across all four quadrants of property investments: debt, equity, public and private.

The Property Council is keen to ensure that the introduction of the DPT regime does not adversely impact Australia's attractiveness as a destination for patient long term global capital.

Australia is heavily reliant on global capital to fund the shortfall between national investment and national savings, which has been on average about 4% of GDP over the last few decades (ABS). We compete with countries around the world for investment in world-class commercial, retail, industrial and residential facilities. Our tax system should be encouraging investment and activity to generate jobs and boost our economy.

Australia already has a robust tax system and our integrity measures have recently been reviewed and are amongst the toughest in the world. For example, the thin capitalisation safe harbour limit was recently reduced from75% to 60%. Australia has also tightened its general anti-avoidance provisions (Part IVA) and amended the foreign dividend exemption to ensure debt-like interests do not benefit from the concession.

We understand the intention of the new DPT regime is to further strengthen Australia's tax regime by imposing a 40 per cent penalty tax on profits that have been artificially diverted from Australia by multinationals. However, the ED is currently drafted very broadly and could potentially apply to ordinary business transactions.

For example, a UK company providing debt funding to its Australian subsidiary could potentially be caught by the DPT regime on the basis that the Australian subsidiary will receive a tax deduction for interest expenses on the debt, and the UK company will be taxed at less than 80% of the Australian corporate tax rate on the interest income.

The lack of clarity in the DPT regime will lead to investor uncertainty as to whether ordinary business transactions could be subject to the DPT. This will inevitably increase transaction costs and lead to Australia being a less attractive investment destination.

The DPT regime should have the following features to ensure Australia remains a competitive destination for global capital:

1. Scope of the DPT regime should be targeted and clear

The ED contains no statement of the purpose of the DPT and it is written in very broad terms, including having a low threshold where its application only requires a "principal purpose", or that the "relevant purpose" be one of several principal purposes.

Given the low threshold that has been adopted for the DPT, it is important to spell out what particular cases are being targeted. It is also very important that the scope of the exclusion referred to in proposed section 177L is very clear. In this regard the ED and explanatory memorandum (EM) are vague.

It is crucial that appropriate guidance is provided in the legislation and explanatory materials.

We also recommend the issuance of ATO Law Companion Guides at the time the legislation is introduced to provide further guidance on how the legislation will be administered. These guides should be jointly developed by ATO, Treasury and taxpayer groups.

2. DPT regime should have express exclusions for passive real estate investments

Treasury has indicated that the DPT is not directed at passive real estate investments.

To avoid any doubt, the legislation should clearly state this intention – that is, the DPT will not apply to passive real estate investment.

3. Tax rate for the "sufficient foreign tax test" should be lowered to reflect international corporate tax rates

One of the key criteria for triggering the DPT regime is the rate of foreign tax payable on the relevant transaction.

The ED currently sets the threshold at 80% of the Australian tax liability which equates to a tax rate of 24%. A 24% tax rate is higher than the corporate tax rate of many of Australia's trading partners – for example, the UK corporate tax rate is currently 20% and will be reducing to 17% in 2020.

Keeping the threshold at 80% would inadvertently bring in transactions between Australia and its major trading partners – countries that would not typically be viewed as "low-tax" regimes.

The sufficient foreign tax threshold should be reduced to a lower level (for example, 50%) – this will ensure the DPT is not triggered unless the foreign jurisdiction tax rate is unacceptably low. This will also make the threshold tax rate comparable to the rate adopted in the UK regime.

4. DPT regime should have express exclusions for debt

The Treasury Discussion Paper on the DPT (May 2016) stated that “where the debt levels of a significant global entity fall within the thin capitalisation safe harbour, only the pricing of the debt and not the amount of the debt will be taken into account in determining any DPT liability”.

This carve out does not appear in the ED. It is crucial that this carve out is introduced.

The DPT should not be used to challenge amounts of debt that are within thin capitalisation limits. It should also be made clear that the DPT cannot apply where the interest rate adopted on a loan satisfies transfer pricing requirements.

We are keen to meet and talk through our industry recommendations at your earliest convenience.

Please let us know when you would be available and in the meantime, if you have any queries, please do not hesitate to contact Belinda Ngo (02 9033 1929) or myself.

Yours sincerely

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