30 March 2016

Mr James Campbell
Director, Banking and Finance,
Public Groups and International,
Australian Taxation Office
Goulburn St
SYDNEY NSW 2000

Dear James,

Industry Risk Assessment
Multinational Anti-Avoidance Law

The Australian Financial Markets Association (AFMA) represents the interests of over 130 participants in Australia's wholesale banking and financial markets. Our members include Australian and foreign-owned banks, securities companies, treasury corporations, traders across a wide range of markets and industry service providers. Our members are the major providers of services to Australian businesses and retail investors who use the financial markets.

AFMA and its members have been considering the technical provisions of the recently enacted Multinational Anti-Avoidance Law (**MAAL**) and any potential application to those members that operate through either a foreign bank branch or subsidiary in Australia. We have noted the ATO's MAAL Client Experience Roadmap and also LCG 2015/2, titled "Section 177DA: schemes that limit a taxable presence in Australia" (**the Law Companion Guideline**).

The purpose of this note is to seek engagement with the ATO on behalf of our members to request a risk assessment based on a sufficiently fungible fact scenario. We make this request in advance of 31 March 2016, pursuant to the Client Experience Roadmap, and note our view that the AFMA members on behalf of which this engagement is sought should be categorised as "Category E: Out of Scope Taxpayers."

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Fact Scenario

The principal basis upon which AFMA seeks a MAAL risk assessment is a scenario where the enterprise has crystallised a permanent establishment in Australia and is subject to Division 815 in terms of ensuring that its dealings are at arm's length for tax purposes, that is, there has not been the avoidance of the crystallisation of a permanent establishment in Australia. In the fact scenario, the Australian customer of the enterprise enters into a transaction directly with the enterprise's head office, and this head office is located in a jurisdiction with a lower corporate tax rate than Australia, say, for example, the United Kingdom.

Such a transaction structure is common and indeed consistent with the business models of many AFMA members to centralise core functions in one particular location. The Australian operations may assist with the management of the relationship between the enterprise and the Australian customer and also provide the customer with the services that the enterprise may be able to offer.

For the purpose of this engagement, it may be assumed that the supplies made by the enterprise to the Australian customer are not solely excluded supplies (i.e. supplies of equity or debt interests in the enterprise). Examples of the supplies under contemplation include a derivative between the Australian customer and head office and also the payment of a fee for service, such as an arranging fee. It may also be assumed that the amounts payable (and taxable) in each jurisdiction are at arm's length and comply with transfer pricing requirements, including Division 815.

Policy View – Application of the MAAL

AFMA understands that, from a policy perspective, the MAAL is aimed at structures where the enterprise has artificially contrived not to crystallise a permanent establishment, or indeed any taxable presence, in Australia. Hence, our *prima facie* view has always been, from a policy perspective, that the MAAL should have no application where such an Australian taxable presence exists, and where the Commissioner has at his disposal the requisite tools, particularly Division 815, to ensure that the amounts attributed to the Australian taxable presence appropriately reflect arm's length remuneration for the functions performed, assets deployed and risks incurred in Australia. It was on this basis that AFMA stated in a submission to the Senate Standing Committee on Economics in October 2015 that "it should be the case that the proposed law has no operation to AFMA members that operate through a branch or Australian-based entity of substance, particularly one that is regulated by APRA and is recognised as a permanent establishment for Australian tax purposes."

We also note a broad policy intent not to disrupt capital markets, as evidenced by the exclusion of supplies of equity and debt interests. In this regard, the comments at paragraph 3.36 of the Explanatory Memorandum are noted, particularly the basis for the exclusions being that if such supplies were included, this could result in "the unintended consequence of capturing the legitimate structures of offshore capital market participants including foreign investors in Australian shares and debt interests."

Technical Application

As noted in the Law Companion Guideline, the necessary conditions for the MAAL to apply are:

- The foreign entity makes supplies to Australia;
- Activities are undertaken in Australia directly in connection with those supplies by an Australian entity that 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, or for more than one principal purpose of…enabling a taxpayer to obtain tax benefits in Australia or both to obtain a tax benefit and to reduce one or more of their foreign tax liabilities.

In the fact scenario, the first criterion is satisfied.

In relation to the second criterion, there may be activities undertaken in Australia by personnel employed by the enterprise. We note that subsections 177DA(ii) and (iii) require that activities be undertaken directly in connection with the supply and that some or all of those activities are undertaken either by an Australian entity or through an Australian permanent establishment of an entity who is an associate of the foreign entity. This would appear to exclude the circumstance where the activities are being undertaken through the Australian permanent establishment of the foreign entity. However we seek confirmation, for the purpose of the risk assessment, that the fact that the personnel undertaking the activities are employed by the foreign entity and referable to the Australian permanent establishment of the foreign entity means that this criterion is not satisfied.

In relation to the third criterion, to the extent that income arises from the supply made by the foreign entity to the Australian customer, some of this income will be attributed to the Australian permanent establishment in accordance with a functional analysis, as required under Division 815 and foreign equivalent regimes. However, it would be expected that not all of the income would be attributed to the Australian permanent establishment as some of the value adding activity will be performed by the foreign entity in its head office jurisdiction. We also seek confirmation that where the income from the Australian customer is *prima facie* derived by the foreign entity, and an appropriate amount is attributed to the Australian permanent establishment as a fee or some other similar charge, this will not change the characterisation of the amount attributed as "that income," for the purpose of Section 177DA(i)(v).

Depending on the ATO's view of the application of these criteria, it may be pivotal to ascertain whether there is a person with a principal purpose of obtaining a tax benefit. Given that under the fact scenario the head office location has a corporate tax rate lower than the Australian headline rate of 30%, we raise for the purpose of the risk assessment whether this criterion may be objectively satisfied.

From our perspective, it is incongruous that a measure aimed at artificial avoidance of the crystallisation of a permanent establishment could apply where there is a permanent establishment, but our reading of the necessary conditions for the MAAL to apply do not automatically lead to this conclusion.

Separate Entity

As the ATO is aware, many AFMA members operate their businesses in Australia through a separate subsidiary. Indeed, for those members that wish to conduct banking business with retail customers, there is a regulatory compulsion for such business to be undertaken by an Australian incorporated entity. In addition, from the supplier's perspective, there is a preference to have all global clients who trade in global securities face one entity in one jurisdiction, so as to allow netting of exposures, resulting in cash and operational efficiencies. That one entity tends to be an offshore entity which may have a larger balance sheet, which is beneficial both from an exposure and also a regulatory capital perspective. Hence, there may be commercial circumstances where the activities being undertaken directly in relation to the supply by the foreign entity to the Australian customer are undertaken by a separate entity as opposed to a branch.

On the flip side, separate entities within the corporate group located outside of Australia may provide services to an Australian customer – for example, a broker that is a market participant with regulatory approval to execute on overseas securities exchange will generally, from a regulatory perspective, be incorporated in the same jurisdiction as the exchange and provide services directly to the Australian customer.

These entities will be subject to Division 815 and the Commissioner already is able to ensure that such activities are appropriately remunerated based on a functional analysis. Hence, our policy view is again that the MAAL should have no application given the robust transfer pricing framework that is already in place. However, from a technical perspective, operating through a separate entity may require a different analysis of the second and third criteria as set out above.

Relevance of Treaty Jurisdiction

The last permutation that AFMA would like to seek the ATO's guidance on is whether the location of the foreign entity, and particularly whether the foreign entity is located in a treaty jurisdiction, has any relevance to the analysis. Given the above references to Division 815 as opposed to Article 7 of a relevant treaty, our view would be that the location of the head office and the supply to the Australian customer should not matter.

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We acknowledge that the ATO may require further information, and hence this note is to flag AFMA's intention to engage on these issues on behalf of its members and to note that such notification was provided in advance of 31 March 2016. We are keen to work with

the ATO to determine the best way to progress the obtaining of an industry risk assessment.

Please contact me if you would like to discuss.

Yours sincerely,

Rob Colquhoun
Director, Policy