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Overview of corporate tax work over last year

Types of corporate tax work

Much of corporate tax work in the year 2018–19 continues to be in advising and assisting corporates with their tax reporting obligations and international tax arrangements.

The Australian Taxation Office's ("**ATO**") review and audit of the Australian subsidiaries of significant global entities (groups with a global turnover of more than A$1 billion) as part of its Top 100 programme and its review and audit of large public and multinational groups with a turnover of more than A$250 million continues through the 2018–19 year as part of its Top 1,000 programme. The focus of this review and audit activity is on transfer pricing, the application of the multinational anti-avoidance law ("**MAAL**") and thin capitalisation. In this review, the ATO has also placed special attention on a group's tax governance frameworks, including its approach to corporate tax disclosure.

Following audit or risk review activity, or as a result of more guidance issued by the ATO, Australian subsidiaries of multinational enterprises ("**MNE**s") applying for Advanced Pricing Arrangements ("**APAs**") also continued through 2018–19. These applications have become more involved than they once were, requiring the applicant subsidiary to devote not insignificant resources to complying with the significantly greater information and economic pricing analysis burden that an APA process now requires.

There continues to be significant corporate tax work from the private sector's involvement in delivering Federal and State Government's infrastructure programmes, whether in road and public transport investment or social infrastructure investment.

Significant deals and themes

Transfer pricing

Since the Senate Committee Hearing on Multinational Tax Avoidance and the Government's adoption of a range of integrity measures aimed at significant global entities ("**SGEs**"), the ATO continues to gather industry information from its review of SGEs. In 2018–2019, the ATO released the following guidance.

Embedded royalties

The ATO has also provided its view on the related issue of embedded royalties in payments under cross-border supply contracts. Through TA 2018/2, the ATO indicated two main concerns:

1) That arrangements between related parties were not being conducted in accordance with the arm's length principle, meaning that Australian entities were gaining a tax advantage through inflated deductions or the reduction of profit by not recognising the value added to transactions by Australian counterparties.

2) That withholding tax on royalties was being avoided by entities disguising royalty payments as mere payments paid solely for a tangible good or service.

Inbound distributors

In March 2019, the ATO released its view on the profit mark-ups for certain related party transactions pursuant to inbound distribution arrangements. PCG 2019/1 is a guide for Australian entities predominantly involved in the distribution of goods purchased from related foreign entities for resale. The ATO recognises four categories of inbound distributors: life sciences; information and communication technology; motor vehicles; and a general distributors category.

An entity's earnings before interest and tax ("**EBIT**") will be compared to its sales to calculate a profit percentage. This profit percentage is then compared to ATO profit markers for the relevant category of entity. An entity will then be classed into either a high, medium or low-risk zone.

Under the 'general distributors' category, low-risk entities will have an EBIT margin of above 5.3%, medium-risk entities between 2.1–5.3% and high-risk entities below 2.1%. A high-risk zone inbound distributor can expect the ATO to apply increased compliance activities through audits or risk reviews. The ATO warns no 'safe harbour' is created by the low-risk zone, and entities must still apply appropriate transfer pricing methodologies.

Demergers

We have recently seen some high-profile demergers within Australia, including the Coles/Wesfarmers demerger (see CR 2018/59) and AMA Group's proposed restructuring (which subsequently fell through after demerger relief was refused).

In March 2019, the ATO released a draft TD 2019/D1 which sets out what constitutes 'restructuring' for the purposes of subsection 125-70(1) of the *Income Tax Assessment Act 1997* (Cth) ("***ITAA 1997***"*)*. The recent TD 2019/D1 has indicated a broader interpretation of 'restructuring' than previously indicated.

Of particular note is an example provided by the ATO which contradicts its previous stance on the availability of demerger tax relief where the demerger involves the 'sale of new interests via a sale facility' ("**Post-Demerger Sale Facility**"). Although ATO ID 2003/1053 (which dealt with this) was withdrawn on 19 February 2010, it found that the use of a Post-Demerger Sale Facility was consistent with sections 125-70(1)(c) and 125-70(2) of the *ITAA 1997*. Despite the ATO's reasoning that this withdrawn publication was a 'straight application of the law', a similar facility is used in Example 5 of TD 2019/D1 which is deemed to be inconsistent with these conditions.

Although TD 2019/D1 provides guidance on how the ATO will award demerger relief, the inconsistency justifies cautionary restructuring if the relief is sought.

Private equity

There is significant potential for high aggregate deal value in the private equity ("**PE**") sphere for the 2019–2020 financial year. Factors contributing to this prediction include high levels of cash reserves held by PE houses and the Australian central bank's decision to implement a record-low cash rate in July. However, in addition to the other changes discussed, the following two significant changes in tax legislation will impact PE transactions from 1 July 2019.

Existing tax exemptions for foreign pension funds and sovereign wealth funds will be limited to passive income and portfolio investments (typically interests of less than 10%).

As discussed below, a minimum 30% withholding tax on trading income converted to passive income distributed by a managed investment trust and as part of a stapled structure.

Key developments affecting corporate tax law and practice

<u>Domestic case law developments</u>

*Federal Commissioner of Taxation v Resource Capital Fund IV LP [2019] FCAFC 51 ("**RCF IV**")*

The much-anticipated decision in *RCF IV* has clarified the tax treatment of corporate limited partnerships in Australia, whilst also addressing a number of other complex international tax issues. The decision overturns the first-instance decision which held that certain gains made by two limited partnerships from a sale of shares in an Australian company should not be taxable in Australia on the basis that limited partnerships are not taxable entities.

RCF IV confirms that limited partnerships are to be treated as companies for Australian income tax purposes and are liable to pay income tax as an entity. Whilst limited partnerships are entitled to rely on treaty benefits, it is somewhat unclear how these benefits can be accessed.

The decision also confirms that a key consideration for determining the source of a gain by an offshore limited partnership fund will be the place of contract formation for the disposal, and that a disposal effected through a scheme of arrangement implemented pursuant to an Australian order will have an Australian source.

*Commissioner of State Revenue v Placer Dome Inc [2018] HCA 59 ("**Placer Dome**")*

On 5 December 2018, the High Court of Australia ("**HCA**") delivered its decision in *Placer Dome* which confirms the approach taken when ascertaining what constitutes an entity's 'goodwill'.

Placer Dome concerned Barrick Gold Corporation's acquisition of Placer Dome Inc ("**Placer**"). In the event that the unencumbered value of Placer's land was equal to more than 60% of the value of all its property, it would fall within the definition of a 'listed land-holder corporation' under Division 3b of part IIIBA of the *Stamp Act 1921* (WA) (now repealed and replaced with the *Duties Act 2008* (WA)), and *ad valorem* duty would be payable.

The HCA held that Placer had 'no material property comprising legal goodwill' and consequently met the 60% threshold. Goodwill for legal purposes extends 'to those sources which generate or add value (or earnings) to the business by attracting custom'.

*Glencore International AG & Ors v Commissioner of Taxation of the Commonwealth of Australia & Ors (S256/2018) ("**Glencore**")*

Glencore has been reserved for judgment by the HCA. In October 2014, the plaintiff engaged a Bermudian law firm to provide legal advice. In November 2017, the law firm had numerous client documents leaked to the media (known as the 'Paradise Papers'). As a result of the leak, the ATO came into possession of documents belonging to the Plaintiff. The issue before the Court is whether client legal privilege extends to restraining the ATO from using the documents, as opposed to the conventional use of legal professional privilege in blocking the compulsory production of such documents.

*Commissioner of Taxation v BHP Billiton Limited [2019] FCAFC 4 ("**BHP**")*

On 29 January 2019, the Full Federal Court handed down its decision in *BHP* which considered the meaning of 'associate' in section 318 of the *Income Tax Assessment Act 1936* (Cth) ("***ITAA 1936***") by reference to what constitutes sufficient influence. Section 318(6)(b) of the *ITAA 1936* states a company will be sufficiently influenced by another entity if the company, or its directors, is under an obligation (whether formal or informal), or might reasonably be expected to act in accordance with the other entity's directions.

The definition of 'associate' in section 318 of the *ITAA 1936* is used widely in Australian tax and, accordingly, this decision will have widespread application.

Recent domestic legislation and guidance changes

Corporate residency

An Australian tax-resident company can be incorporated in Australia, or not be incorporated in Australia if it carries on business in Australia with either central management and control in Australia or its voting power is controlled by shareholders who are residents of Australia. Most of Australia's tax treaties include a tie-breaker rule for dual-residency, usually by reference to the place of effective management, though this will be modified/removed for some treaties pursuant to the OECD Multilateral Instrument ("**MLI**").

The ATO has updated its guidance on the meaning of these tests in TR 2018/5 and PCG 2018/9, following the HCA decision in *Bywater Investments Limited v Commissioner of Taxation* (2016) 260 CLR 169.

Consolidation regime

In March 2018, the Federal Government introduced amendments to Australia's tax consolidation regime. The new laws provide certainty to multiple-entry consolidated groups in relation to how the integrity measures affect the tax cost-setting rules and calculation of allocable cost amounts for entities that join or leave the group.

Hybrid mismatch rules

This year, Australia joined the United Kingdom and New Zealand with the commencement of Australia's hybrid mismatch rules.

Australia's hybrid mismatch rules apply to certain payments made after 1 January 2019 and to income years commencing on or after 1 January 2019, irrespective of whether the underlying arrangement was entered into before or after that date. Whilst the existence of a 'payment' underpins the operation of Australia's hybrid mismatch rules, the term is deceptively narrow. In addition to capturing transfers of cash and non-cash benefits, the decline in value of an asset, an amount which represents a share in the net loss of a transparent entity (such as a partnership) and accrued amounts can also be caught.

Broadly, the rules seek to neutralise deduction/non-inclusion and deduction/deduction outcomes. It also applies to neutralise 'imported hybrid mismatches', whereby a deductible payment made by an Australian taxpayer is shielded from tax directly or indirectly by a hybrid arrangement entered into elsewhere within the corporate group. Neutralising a mismatch can involve a deduction being denied in Australia. However, and perhaps more alarmingly, the measures can result in amounts being deemed to be included assessable income.

These rules pose significant challenges for both private and in-house tax practitioners. Not only do the rules require knowledge about the operation of foreign tax regimes, but also an intimate knowledge of intra-group arrangements which exist within a corporate group, even if there is no obvious direct link with Australia. The latter may prove to be a particular challenge for Australian companies in foreign multinational groups as the rules assume a level of knowledge and intimacy with the rest of the group's tax affairs which, in practice, may not exist. Perhaps the only respite, albeit a temporary one, is that Australia's imported hybrid mismatch rule will only apply to non-structured arrangements from income years commencing on or after 1 January 2020 (which is intended to align with the European Union's introduction of hybrid mismatch rules).

Finally, whilst Australia's hybrid mismatch rules generally follow the OECD model which came out of BEPS, with measures including amendments that deny imputation (i.e. franking) benefits on distributions which are deductible in a foreign jurisdiction and denying access to Australia's participation exemption for distributions that are deductible in a foreign jurisdiction, there is one uniquely Australian feature to the Australian hybrid mismatch rule.

The unique feature (and key departure from the OECD model) is the inclusion in Australia's hybrid mismatch rules of a targeted integrity measure which will have a significant impact on intra-group financing arrangements within a multinational group. Very broadly, the integrity rule has the potential to deny deductions on interest payments (or amounts in substitution for interest) and payments under derivative financial arrangements which are not subject to foreign income tax in at least one jurisdiction at a tax rate of more than 10%. Accordingly, groups with special purpose financing vehicles in low-tax jurisdictions will need to carefully analyse their existing funding structures.

Thin capitalisation

The thin capitalisation rules have been amended to deny foreign investors from taking advantage of 'double-geared' structures which seek to convert active business income to interest income (subject to a lower withholding tax rate). These structures were achieved by 'layering' multiple flow-through entities, each of which issued debt against the same underlying asset allowing investors to gear higher than the thin capitalisation limits intended.

The 'associate entity' provisions in subdivision 820-I of the *ITAA 1997* were intended to prevent these double-gearing arrangements by requiring the grouping of associate entities when working out each entity's debt limit. Prior to 1 July 2019, an entity would only be an 'associate' if the interest held in an underlying trust or partnership was 50% or more. Since 1 July 2019, however, an entity will be an associate if the other entity holds 10% or more in the underlying trust or partnership.

An integrity measure has also been included through the operation of sections 820-905(2B)(b) and 820-905(2C) of the *ITAA 1997*, which treat the holdings of two or more related entities holding less than 10% to be associates if it is reasonable to conclude that one of the entities did so for the principal purpose of ensuring the other entity or entities would not be an associate.

Foreign citizen stamp duty

States generally

Foreign buyers (depending on how foreign person is defined) may pay the following foreign surcharge duty in addition to transfer duty in respect of the purchase of mainly residential property:

- 8% (in New South Wales);
- 7% (in Victoria, Queensland, Western Australia and South Australia);
- 3% or 0.5% (in Tasmania, depending on whether the property is residential or primary production property); or
- 0% (in the Australian Capital Territory and Northern Territory).

New exemption in New South Wales

From 1 July 2019, there is an exemption from the foreign person surcharge duty if a retirement visa (subclass 405 or 410) is held. This is significant because retirement visa holders are merely temporary visa holders.

Similar business test

On 1 March 2019, the similar business test was introduced with the effect of increasing the ease of which companies can access their previously incurred tax losses. As a result, company tax losses incurred throughout previous income years can now be carried forward and deducted in future income years if they, throughout the relevant test period, continue to carry on a 'similar business' to previous income years.

Generally, the regime now permits tax losses from prior income years to be deducted against the assessable income of a company in a later income year if:

1) the continuity of ownership test ("**COT**") is satisfied; or
2) where a company fails the COT, the business continuity test ("**BCT**") is satisfied. In general terms, the BCT will be satisfied if the company either:
   (a) carries on the same business as it carried on immediately before the test time ("**Same Business Test**"); or
   (b) carries on a business that is similar to the business it carried on before the test time ("**Similar Business Test**").

LCR 2019/1 echoes section 165-211 of the *ITAA 1997* and sets out four mandatory factors to be considered when ascertaining whether a current business is a 'similar business' to the former business. These factors to consider include:

1) the extent to which the assets (including goodwill) used in the current business were also used in the former business to generate assessable income;
2) the extent to which the activities and operations of the current business were also the activities and operations from which the former business generated assessable income;
3) the identity of the current business compared to the former business; and
4) the extent to which any changes to the former business resulted from development or commercialisation of assets, products, process, services or marketing or organisation methods of the former business.

Importantly, practitioners should note that the Similar Business Test can only be used to access tax losses, net capital losses, or bad debts incurred on or after 1 July 2015.

<u>Stapled structures</u>

As communicated by TA 2017/1, the ATO was concerned that stapled structures may be used to re-characterise trading income into more favourably-taxed passive income. Under a stapled structure, income that may be subject to company tax can be diverted to a related trust where, on distribution from the trust, that income is subject to no tax or a lesser rate of tax than the corporate tax rate.

In an effort to limit access to concessions available to foreign investors for passive income, the *Treasury Laws Amendment (Making Sure Foreign Investors Pay Their Fair Share of Tax in Australia and Other Measures) Act 2019* (the "**Stapled Structures Act**") was introduced.

Under Schedule 1 of the Stapled Structures Act, the managed investment trust ("**MIT**") withholding rate on fund payments that are attributable to non-concessional MIT income was increased to 30%.

This increased withholding rate applies from 1 July 2019.

<u>BEPS</u>

BEPS and OECD Multilateral Instrument

Australia remains committed to the BEPS Action Plan and has now implemented recommendations from BEPS Actions 2, 5, 8–10, 13, 14 and 15.

Australia ratified the MLI on 26 September 2018 and, by virtue of domestic legislation that received royal assent and became law on 24 August 2018, the MLI entered into force in Australia on 1 January 2019.

It is expected that the MLI will modify 32 of the 45 bilateral tax treaties currently in force with Australia. Key MLI positions Australia has adopted include the fiscally transparent entity provisions, the principal purpose test and the mandatory binding arbitration articles (subject to certain conditions).

Tax climate in Australia

Consistent with global trends, Australia's economy has been slowing. As a result, the Federal Government continues to implement corporate tax relief and tax concessions, while simultaneously working to reduce the tax gap and achieve an operating surplus of approximately A$7.1 billion for the 2019–20 year. The ATO estimates that the net income tax gap for large corporate groups was A$1.8 billion in 2015–16, which is equivalent to 4.4%. By comparison, the ATO estimates that the net tax gap for individuals not in business is A$8.76 billion, equivalent to 6.4%. Due to the community perception of large MNEs and pressure to build confidence in the community, MNE tax compliance remains high on the ATO's agenda. The ATO is also turning greater attention to the black (or cash) economy to reduce the small business income tax gap, estimated at approximately A$10 billion.

Corporate tax relief

Australia continues to implement its plan to gradually lower the corporate tax rate for corporate entities who meet the aggregated turnover threshold and have no more than 80% base rate entity passive income. The plan commenced from the 2016 income year, before which time all corporate entities were subject to a tax rate of 30%. For this income year, the corporate tax rate for entities with aggregated turnover under A$50 million, and no more than 80% base rate entity passive income, is 27.5%. By the 2022 income year, this rate will be down to 25%. All other corporate entities remain subject to a corporate tax rate of 30% in Australia.

Instant asset write-off

In the days following the announcement of Australia's 2019 Federal budget ("**2019 Budget**"), the *Treasury Laws Amendment (Increasing and Extending the Instant Asset Write-Off) Act 2019* was passed to expand the availability of instant asset write-offs for small businesses under the *ITAA 1997*. The instant asset write-off provisions allow small businesses to write off assets in the first year in which they are used or installed ready for use. The legislation extends the operation of the provisions by 12 months to 30 June 2020. The legislation also expands the scope of the concession to cover assets costing less than A$30,000 and to include medium-sized businesses with an aggregated turnover from A$10 million up to A$50 million for assets acquired after 7.30pm AEDT on 2 April 2019. Business with an aggregated turnover of up to A$10 million can also access the instant asset write-off for assets costing less than A$25,000 and acquired from 29 January 2019 until before 7.30pm (AEDT) on 2 April 2019, and assets costing less than A$20,0000 and acquired from before 29 January 2019.

ATO Tax Avoidance Taskforce

As part of the 2019 Budget, the Government announced it will provide additional funding of A$1 billion over four years from 2019/20 to extend the operation of the ATO's Tax Avoidance Taskforce. The Tax Avoidance Taskforce was established in 2016 and undertakes compliance activities targeting MNEs, large public and private groups, trusts and high wealth individuals. The Government has noted that the funding will allow the Taskforce to expand its activities, including increasing its scrutiny of specialist tax advisors and intermediaries that endorse tax avoidance schemes and strategies. The Government estimates that the additional funding for the Taskforce will result in a fiscal gain of A$3.6 billion over the forward estimates period.

Black economy: strike approach and TRPS expansion

It has been estimated that the black (or cash) economy costs the broader community an estimated A$50 billion. Common practices contributing to the problem include not declaring income, not recording all income, and not reporting income from weekend sales. To address the problem, the ATO is implementing a 'mobile strike approach' that will see it visit up to 10,000 businesses around Australia each year for the next three to four years, and expanding the taxable payments reporting system ("**TPRS**") under which certain businesses need to report the payments they make to contractors for services. Since 1 July 2019, businesses in IT, road freight and security and investigative services industries have been required to start reporting through the TPRS.

As part of another initiative to combat the black (or cash) economy, since 1 July 2019, businesses wanting to tender for Commonwealth Government contracts over A$4 million (including GST) have also needed a statement of tax record from the ATO.

Client legal privilege

In recent years, the ATO has become increasingly sceptical about CLP claims. At the Australian Tax Institute's 34th National Convention, held in March 2019, Commissioner Chris Jordan stated that the ATO '[will] be taking a tougher stance in the future' due to rising concerns that CLP is being relied on to 'cheat the system' and conceal contrived tax arrangements.

At the National Tax Liaison Group held on 30 November 2018, the ATO provided supplementary materials exploring its key concerns with purported CLP claims. These broadly concerned claims made with reckless disregard as to satisfying the elements of a CLP claim or possible waiver, advice being prepared by non-lawyers but rubber stamped by lawyers, and claims being made over non-privileged commercial/entrepreneurial advice. Once again, these were all underpinned by an apprehension of tax avoidance.

In addition to CLP, the ATO offers administrative concessions such as the Accountant's Concession and Corporate Board Advice Concession which largely preserve confidentiality for tax compliance advice received from qualified accountants or to corporate boards. Currently, the ATO maintains that such concessions will only be lifted in 'exceptional circumstances'.

APAs and MAPs

The ATO continues to encourage taxpayers to enter in APA and mutual agreement procedures ("**MAPs**") in respect of the international tax arrangements with their related parties. However, there also continues to be criticism of the administration of these programmes by the ATO.

All of Australia's treaties in its treaty network contain a MAP provision. On 30 August 2018, the Stage 1 MAP Peer Review Report for Australia was published (as part of the BEPS Action 14 peer review and monitoring process, which was launched by the OECD in December 2016). The report found that Australia's treaty network was not yet fully compliant with the BEPs Action 14 minimum standards. The report also observed that there is limited guidance on the availability of MAP in Australia.

Taxpayers have reported experiencing problems when negotiating APAs with the ATO, including long delays, numerous and onerous information requests and indecisiveness by the ATO. Some APAs remain unresolved after three or four years of negotiation. In recent times, the number of active APAs has been declining significantly. Since the 2012 income year, the number of active APAs has decreased by 30%.

Disclosure requirements and tax governance

Tax Transparency Code

In February, the Board of Taxation released a consultation paper which provided a post-implementation review of the Tax Transparency Code ("**TTC**"), as well as some proposed changes to the current framework. These included changes to minimum standards and best practice, the inclusion of a 'basis of preparation statement' and reconciliation between reports produced under the TTC and the ATO annual corporate tax transparency disclosures. The Board accepted external views on the proposed changes until late March – no update has been provided as yet.

Justified Trust Program and risk ratings

The ATO continues to employ the Justified Trust Program to the top 100 and top 1,000 taxpayers simultaneously. The year of 2019 is the final one in which the ATO will apply risk categorisations to the top 100. The three tiers of categorisation are (from low to high): key taxpayer; key taxpayer with significant concerns; and higher risk. The ATO will provide further guidance on the 2020 approach to top 100 risk ratings later in the year.

*Reportable Tax Position ("**RTP**")*

Since 30 June 2019, the ATO no longer issues notifications to taxpayers required to lodge an RTP. The task of assessing the necessity of lodgement now rests with the taxpayer. In most cases, satisfying all of the following criteria means lodgement of an RTP is required:

- having a public company or a foreign owned company;
- having total business income of A$25 million or more in the current tax return; and
- being part of a public or foreign owned economic group with a total business income of A$250 million or more in the current or immediately prior year.

*Country-by-country ("**CbC**") reporting*

The ATO continues to enforce obligations on SGEs as a means to successfully implement CbC reporting (Action 13 of the BEPS Action Plan). The obligations include providing a CbC report, Master file and Local file.

Tax authorities sharing information globally

In addition to standard information-sharing practices, the ATO has played a significant role over the past year as part of J5. J5 is a team of tax authorities from Canada, USA, the Netherlands, the UK and Australia that aims to combat international tax evasion and money laundering. A media release published in June 2019 outlined that J5 is currently involved in more than 50 investigations. The sharing of intelligence and data in real time plays an integral role in J5's success.

Developments affecting attractiveness of Australia for holding companies

Australia has three key measures in its domestic tax law which are intended to make Australia a more attractive jurisdiction for holding companies. These have not changed.

First, non-deductible dividends derived by Australian tax resident companies obtain the benefit of a participation exemption where the Australian tax resident company holds at least 10% of the foreign resident company.

Second, Australia has a participation exemption in respect of capital gains derived from capital gains tax events with respect to shares held by Australian tax resident companies in foreign resident companies where the Australian tax resident company holds at least 10%

of the foreign tax resident company. The participation exemption is reduced to the extent that the foreign tax resident company is not carrying on active business.

Third, Australian domestic tax law provides 'conduit foreign income' rules (or "**CFI rules**"). Under the CFI rules, dividends paid out of profits sourced from dividends and capital gains that obtain the benefit of the participation exemptions are not subject to Australian dividend withholding tax.

Industry sector focus

E-commerce/digital economy

Digitalisation and e-commerce are increasingly enabling firms to play a significant economic role in Australia despite having a limited physical presence within the jurisdiction. In an attempt to address this evolving business practice, a Treasury Discussion Paper titled 'The digital economy and Australia's corporate tax system' was released in October 2018. Amongst other things, the paper indicates that legislative and policy changes are required to address the nature of this industry through mechanisms such as the recent introduction of BEPS reporting.

Concurrently, MAAL, which took effect from 1 January 2016, acts as another form of integrity measure within Part IVA of the *ITAA 1936*. MAAL only applies to foreign entities that are considered significant global entities that have significant activity in Australia and seeks to prevent artificial structures and arrangements that result in the avoidance of a taxable presence in Australia. The 'look through' provisions which allow for the assessment of the intent behind certain arrangements as well as the expanding of the definition of significant global entity, effective from 1 July 2018, are particularly noteworthy.

Pharmaceutical

The ATO is currently engaged in a review of the tax compliance and transfer pricing practices of the pharmaceuticals industry. This is focused on related party financing, thin capitalisation, intellectual property migration, consolidation, business restructures and research and development.

Diverted profits tax came into effect on 1 July 2017, ultimately imposing a tax rate of 40% on amounts of diverted profits. It is aimed at arrangements where profits made in Australia are diverted to a tax jurisdiction where the tax rate is less than 24%. Businesses need to consider their status as significant global entities as well as the structuring of their arrangements to determine whether these provisions would apply.

Energy and resources

In Australia, the tax landscape in the energy and resources industry is heavily influenced by the Energy and Resources Working Group. This is a group comprised of representatives of tax professional bodies, resource industry associations and the Australian Taxation Office.

In Australia, there exists a regime of fuel tax credits which allows businesses to claim credits for the fuel tax, whether it be excise or customs duty that is inherently included in the price of fuel used in business activities. This is caveated by certain requirements under the scheme, including that the business must be registered for GST and that it does not apply to fuel used by light vehicles on public roads. The amount of fuel tax credit available is calculated by multiplying the number of eligible litres of fuel by the applicable rate. This applicable rate changes twice a year in both February and August based on the consumer price index.

The Petroleum Resource Rent Tax ("**PRRT**") is a tax on profits generated from the sale of oil and gas products which are referred to as Marketable Petroleum Commodities ("**MPCs**"). PRRT arises in situations in which a project has recovered all eligible expenditure including certain exploration costs resulting in a certain threshold rate of return on these outlays. The amount of PRRT paid is reduced by the amount of royalties and excise paid in the relevant State and Federal jurisdictions. From 1 July 2019 changes will be made to this regime, including removal of onshore projects from its hold. Note that these projects will still be subject to the applicable State Royalties. Given the volatility of commodity prices, the ATO have flagged an intention to enter into Annual Compliance Arrangements ("**ACAs**") and APAs.

Financing arrangements

Following an Australian Full Federal Court's decision in *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation* (2017) 251 FCR 40, the ATO has published further guidance setting out its views on the transfer pricing issues associated with financing arrangements. Recently, the ATO has issued:

1) PCG 2017/4 in relation to cross-border related party financing arrangements and related transactions. An updated version of this PCG has been issued as a draft for public comment until 31 August 2018;
2) PCG 2017/8 in relation to the use of internal derivatives by multinational banks;
3) TD 2018/D6, concerning the interaction between Australia's transfer pricing provisions in subdivision 815-B and debt/equity characterisation rules in Division 974 of the *ITAA 1997*; and
4) TR 2019/D2, which provides updated guidance on the 'arm's length debt test' in the thin capitalisation provisions, including discussion on how the arm's length debt test interacts with the transfer pricing rules.

Hubs

Offshore hubs remain a key focus of the ATO in the context of transfer pricing and international risk. On 11 October 2018, the ATO updated PCG 2017/1 by publishing a new Schedule focused on Australian tax risk assessment for offshore non-core procurement arrangements. PCG 2017/1 was originally released in January 2017 with initial guidance focusing on marketing hubs.

The year ahead

In the 2019 Budget, the Federal Government forecast a budget surplus of A$7.1 billion for 2019/20. This would be Australia's first surplus in 12 years. However, this is a modest surplus and, in the year ahead, the Government will continue to employ tax incentives as a stimulus for a slowing economy (such as the expansion of the instant asset write-off outlined above).

In July 2019, the Federal Government was able to pass personal income tax cuts which will phase in over three stages over the period 1 July 2018 to 1 July 2024. By 1 July 2024, the income tax scales applying to the taxable income of individuals will be streamlined. The four tax brackets which currently apply will be reduced to three tax brackets with the 37% bracket being abolished, leaving taxable income in the range of A$41,000 to A$200,000 being subject to a 32.5% tax rate.

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