Diverted Profits Tax: U.K., Australian, and New Zealand Approaches

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In this article, the authors examine aspects of new antiavoidance rules in the United Kingdom, Australia, and New Zealand.

Over the last several years, governments have expressed concern that multinational enterprises are exploiting gaps in the international tax system to minimize their tax bills. In response, the OECD launched its base erosion and profit-shifting project in 2013 (with final recommendations published in late 2015) to create a unified solution.

The OECD has suggested that MNEs have been taking advantage of the gaps that arise when domestic laws and tax treaties of multiple jurisdictions interact. High-tech companies in particular have borne the brunt of that criticism because their business models present challenges for revenue authorities. Systems that impose taxes based on a taxpayer's physical presence are ill-suited to e-commerce, including online advertising, cloud computing, and online payment services.

The U.K. government was an early proponent of the BEPS project, so its announcement of a diverted profits tax (DPT) in December 2014 came as a surprise to the business community. It was a unilateral move that seemed to jump the gun on BEPS work in order to protect the U.K. tax base. Officially, however, the U.K. government marketed the DPT as consistent with the principles of the BEPS project, aligning taxing rights with economic activity.

Australia followed the U.K.'s lead and in 2015 unilaterally introduced the Multinational Antiavoidance Law (MAAL) (modeled broadly on one of the two limbs of the U.K.'s DPT) and its own DPT (modeled broadly on the other limb of the U.K.'s DPT).

In March the New Zealand government released a discussion paper on permanent establishment avoidance and transfer pricing. The paper rejects a DPT and outlines the government's proposed measures to counter BEPS activities by strengthening New Zealand's domestic legislation and aligning its rules with OECD guidelines and other developments abroad. While the New Zealand government does not intend to introduce a DPT, its proposed measures include several elements from the U.K.'s DPT and Australia's DPT and MAAL.

This article examines aspects of those new antiavoidance rules, including the context for

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reform, key features of the rules, the risk of domestic and foreign double taxation, the actual and anticipated outcomes, and whether unilateral action is consistent with supporting the OECD's efforts to address BEPS.

I. Context for Reform

Tax reform has always been an integral and controversial part of the political landscape. The United Kingdom's incumbent Conservative Party introduced the DPT in response to criticisms of its "penchant for protecting big business."[1] Days after that critique, then-Chancellor George Osborne spoke at the Conservative Party convention, noting the government's frustration that despite lowering the U.K. corporation tax rate from 30 percent in 2008 to 19 percent starting April 1, 2017, and to 17 percent on April 1, 2020, MNEs (particularly tech companies) still did not seem to be paying their fair share of tax.

Australia's production and export of natural resources were at record levels for about a decade, beginning in 2003. During that time, the government spent much of the mining boom windfalls on policies, such as reducing personal income taxes, that were popular with voters but not easy to reverse in less prosperous times. MNEs, with their deep pockets and complicated corporate structures, were easy targets for lawmakers, who argued that MNEs were deliberately shifting profits out of Australia to low-tax jurisdictions at the expense of hardworking "mom and pop" taxpayers. The government looked to them to fill the void in revenue left by a lower iron ore price and declining mining productivity since 2013.

Further, following global media pressure on MNEs and the commencement of the OECD BEPS project in October 2014, the Australian Senate referred an inquiry into corporate tax avoidance to the Senate Economics References Committee. Public hearings were held and evidence was given by academics and representatives of MNEs, industry groups, and government agencies (including the tax commissioner). In May 2015 the government announced it would introduce a MAAL that would take effect on January 1, 2016. The inquiry committee delivered an interim report in August 2015 and a second report in April 2016.[2] The DPT was announced a month later.

New Zealand's political environment is not as highly charged as those in the U.K. and Australia; the media commentary on MNEs has been relatively benign. Further, New Zealand has not suffered the same fiscal pressures, given its recent strong economy. Those factors may have contributed to the government taking a less aggressive approach.

II. Key Features of the Law

The U.K.'s DPT legislation is in Finance Act 2015 and applies from April 1, 2015. It has two distinct limbs: the diverted profits charge (on which Australia's DPT is based) and the avoided PE charge (equivalent to Australia's MAAL).

In Australia, the MAAL commenced on January 1, 2016, and was introduced by the Tax Laws Amendment (Combating Multinational Tax Avoidance) Act 2015. The Australian DPT commenced on July 1, 2017, and was introduced by the Treasury Laws Amendment (Combating Multinational Tax Avoidance) Act 2017 and the Diverted Profits Tax Act 2017.

In New Zealand, legislation implementing the measures in the discussion draft has not yet been released, making it unlikely that the proposed changes would apply earlier than the second half of 2018.

A. Rate

In some cases, the new antiavoidance measures apply at a rate higher than the corporation tax rate (see table).

New Antiavoidance Rates

	U.K.	Australia	New Zealand
Current Corporation Tax Rate	19%	30%	28%
DPT Rate	25%	40%	N/A
Avoided PE (Australia – MAAL) Rate	25%	30%	56%

[1] "The Tories' Penchant for Protecting Big Business," *Financial Times*, Oct. 1, 2015.

[2] Australian Economics References Committee, "Corporate Tax Avoidance Part I: You Cannot Tax What You Cannot See" (2015); and "Corporate Tax Avoidance Part II: Gaming the System" (2016). The committee is scheduled to report again by September 30.

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B. Scope

The U.K. DPT applies to all corporate entities apart from small and medium-size enterprises. SMEs are enterprises that employ fewer than 250 people and either have annual turnover not exceeding €50 million or annual total balance sheet assets not exceeding €43 million.

Australia's MAAL and DPT apply to significant global entities, which are global parent entities with annual global income of at least AUD 1 billion, and to members of groups of entities that are consolidated for accounting purposes as a single group with one member being a global parent entity whose annual global income is at least AUD 1 billion.

New Zealand's proposed rules are intended to apply to MNEs with a global turnover of €750 million or more, which is in line with the OECD's threshold for country-by-country reporting by large MNEs.

C. Diverted Profits Charge

1. U.K.

A charge applies under Finance Act 2015, section 80, if there is a transaction or series of transactions between a U.K. company (or a U.K. branch of a nonresident company) and another company under common control, there is an effective tax mismatch outcome, and the insufficient economic substance condition is met.

There is an effective tax mismatch outcome when, in connection with the supply of goods or services, a transaction (other than a loan) that reduces the tax liability of one party increases the tax liability of the other party by less than 80 percent of the reduction — that is, when there is a reduction in the overall tax liability of at least 20 percent.

The insufficient economic substance condition is satisfied if:

- the tax reduction's financial benefit for both parties is greater (on a consolidated basis) than any other financial benefit referable to the transactions, and it is reasonable to assume that the arrangements were designed to secure the reduction (transaction-based test, essentially a test of commerciality); or
- the tax reduction's financial benefit would exceed the nontax financial benefit of the contributions of the person's staff, and it is reasonable to assume the person's involvement in the transaction was designed to secure the tax reduction (entity-based test, focused on functions of a person's staff).

There are two problems with those provisions. First, arrangements can be designed to secure a tax reduction while also being designed to secure a commercial objective. Second, the provisions would capture transactions even when the nontax financial benefits are significant.

2. Australia

Australia's DPT will apply from July 1 when:

- the taxpayer is a significant global entity that obtains a DPT benefit in connection with a scheme (regardless of whether the scheme was entered into or commenced being carried out before or after July 1);
- at least one principal purpose of a person (or persons) entering into or carrying out the scheme (alone or with another taxpayer) is to obtain an Australian tax benefit, or to obtain an Australian tax benefit and reduce one or more of the relevant taxpayer's (or another taxpayer's) foreign tax liabilities; and
- it is reasonable to conclude that none of the following tests is satisfied by the relevant taxpayer for the DPT benefit:
  - *AUD 25 million income test* — this test is satisfied if it is reasonable to conclude that the sum of the assessable income, exempt income, and nonassessable nonexempt income of the relevant taxpayer; the assessable income of any other associated group entities; and, if the DPT benefit relates to an amount not being included in assessable income, the amount of the DPT benefit, does not exceed AUD 25 million;
  - *sufficient foreign tax test* — this test is satisfied if the increase in the foreign tax liabilities of foreign entities resulting from the scheme is at least 80 percent of the reduction in the Australian tax liability of the relevant taxpayer; or

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- *sufficient economic substance test* — this test is satisfied if the profit made as a result of the scheme by the relevant taxpayer and by each associated entity that entered into or carried out, or is otherwise connected with, the scheme (or part thereof) reasonably reflects the economic substance of the entity's activities in connection with the scheme.

The sufficient foreign tax test mirrors the U.K.'s effective tax mismatch outcome described above but could have a very different effect in practice. The U.K. corporation tax rate is so low that essentially only transactions with tax havens would be affected. Australia, by comparison, has one of the highest corporate tax rates among OECD countries, making it more difficult to show that sufficient foreign taxes are paid relative to the reduction in Australian tax.

The sufficient economic substance test is similar to the U.K. entity-based test in that it measures the economically significant entities (and the functions they carry out, taking into account the assets used and risks assumed) and compares them to the relative profits earned. The economic substance of an entity's activities (and the functions carried out) are considered in connection with the scheme and not the overall economic substance of the entity itself.

3. New Zealand

The discussion draft proposes that the New Zealand Parliament combine specific features of a DPT with OECD BEPS measures and some domestic amendments to produce a package of measures tailored to New Zealand. The proposed package does not include a DPT like those introduced in the U.K. and Australia, and instead includes a PE antiavoidance rule and amendments to the source rules, strengthened transfer pricing rules, and administrative rules that make it easier to assess uncooperative MNEs.

D. Interaction With Transfer Pricing Rules

1. U.K.

Section 80 of the U.K.'s DPT applies separately from, and in addition to, existing transfer pricing rules and other antiavoidance measures and is potentially more powerful than the transfer pricing rules. Transfer pricing focuses on attributing value based on the contributions of individual enterprises, whereas the DPT involves an analysis of the entire arrangement on a consolidated basis. It is possible to recharacterize the entire arrangement and proceed on the relevant alternative hypothesis that the arrangements would not have been entered into at all if not for the tax benefits.

2. Australia

Like the U.K., Australia's DPT applies separately from, and in addition to, existing rules and measures. The revised explanatory memorandum to the legislative bills introducing the DPT said the tax will encourage greater MNE tax compliance, including with Australia's transfer pricing rules.[3] It also stated that the DPT is not a provision of last resort and will be applied only in limited circumstances. However, it is unclear what those circumstances are or how the DPT and transfer pricing rules fit together or will interact, which will create uncertainty for MNEs operating in Australia.

3. New Zealand

It is arguable that the diverted profits charges in Australia and the U.K. are not required. New Zealand's proposed solution to the apparent concerns regarding MNE activities is to strengthen its transfer pricing rules so they align with the OECD's latest guidelines and Australia's transfer pricing rules by, for example, focusing more on substance over form, shifting the burden of proof from the commissioner to the taxpayer, and increasing the time limit for reassessment from four to seven years. If the activities performed in New Zealand by the related entity result in its being appropriately remunerated under stronger transfer pricing rules, the taxable income in New Zealand cannot vary from income that arises under Australia's DPT or the U.K.'s section 80 charge. However, the Australian and U.K. governments might still say their DPT rules are necessary because they contain a penalty not found in transfer pricing rules that could change taxpayer behavior.

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[3] Senate Economics Legislation Committee, "Treasury Laws Amendment (Combating Multinational Tax Avoidance) Bill 2017 and Diverted Profits Tax Bill 2017 (Commonwealth)," revised explanatory memorandum (2017).

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E. Avoided PE Charge

Under U.K. law, a non-U.K. resident company is liable for U.K. corporation tax only if it carries on a trade in the U.K. through a PE there, with PE defined to include a dependent agent who habitually exercises authority to do business (or conclude contracts under the slightly narrower terms of many U.K. tax treaties) on behalf of the nonresident.

The Australian definition excludes an agent "who does not have, or does not habitually exercise, a general authority to negotiate and conclude contracts," although that can vary depending on the treaty terms.

Under New Zealand law, a nonresident company is liable for all income that has a New Zealand source, which includes income derived from a business that is wholly or partly carried on in New Zealand and from contracts made or performed in New Zealand. However, under its tax treaties, New Zealand has a right to tax business income only if the enterprise has a PE there. In most of its treaties (including with the U.K.), a PE arises when a dependent agent habitually exercises an authority to conclude contracts. In some treaties (including with Australia), the definition includes the slightly broader language of "substantially negotiate or conclude contracts."

BEPS action 7 seek to address arrangements that circumvent PE rules. To address arrangements designed to fall just short of creating a taxable presence, action 7 focuses on widening the definition of PE in tax treaties. For example, a taxable presence is created not just by a person who concludes contracts, but also by a person who "habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise."

1. U.K.

Section 86 of Finance Act 2015, the avoided PE limb of the U.K.'s DPT, targets structures that deliberately avoid creating a taxable presence in the U.K. It does so not by widening the concept of a PE (as proposed by the BEPS project), but by unilaterally imposing a tax when a person (the avoided PE) carries on activity in the U.K. in connection with the supply of goods or services made by a non-U.K. resident company to customers in the U.K. when:

- the avoided PE is not a U.K. PE of the non-U.K. resident;
- it is reasonable to assume that any of the activity of the avoided PE or non-U.K. resident company is designed (for example, by way of agreed limitations on their respective activities) to avoid the creation of a U.K. PE (whether or not it is also designed to secure any commercial or other objective); and
- either the mismatch condition (in that it is reasonable to assume there is an effective tax mismatch outcome and the insufficient economic substance condition is met) or the tax avoidance condition is met (one of the main purposes is to avoid corporation tax).

Agents of independent status, who are long-standing exceptions to the PE rules, are exempted from the avoided PE limb of the DPT.

Section 86 does not apply if the total U.K.-related sales revenue of the foreign company (and its connected companies) does not exceed £10 million or if the value of U.K.-related expenses does not exceed £1 million.

2. Australia

The MAAL is designed to prevent MNEs from eroding the Australian tax base by using artificial or contrived arrangements to avoid having a taxable presence in Australia. It applies if:

- the foreign entity is a significant global entity;
- having regard to certain matters, it could be concluded that a person entered into or carried out the scheme (or part thereof) for a principal purpose of enabling at least one taxpayer to obtain a tax benefit or to obtain both a tax benefit and reduce at least one of its foreign tax liabilities; and
- under the scheme:
  - a foreign entity makes supplies for Australian customers;
  - activities are undertaken in Australia directly in connection with the supplies;
  - some or all of those activities are undertaken by an Australian entity (or at or through an entity's Australian PE) that is an associate of, or commercially dependent on, the foreign entity;

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- the foreign entity derives income from the supplies; and
- some or all of the income is not attributable to an Australian PE of the foreign entity.

The MAAL does not apply to supplies made through an independent agent or to supplies that relate to intragroup sales. Other supplies, such as the supply of (or an option to supply) an equity or debt interest, are excluded because they could result in unintended consequences and capture legitimate structures (for example, foreign investors in Australian shares and debt interests).

If the MAAL applies, the commissioner can make a determination and, based on a reasonable alternative postulate, apply the tax rules as if the foreign entity had been making a supply through an Australian PE — that is, cancel the tax benefit. The tax benefit is likely to include the income from the supply that would have been attributable to a foreign entity's Australian PE, less any allowable deductions properly referable to the supply.

3. New Zealand

New Zealand's proposed PE antiavoidance rule contains features of the U.K. DPT and the Australian MAAL. It would apply if:

- a nonresident member of a multinational group with global turnover of more than €750 million sells goods or services into New Zealand;
- a related entity (either associated or commercially dependent) carries out an activity in New Zealand in connection with that particular sale for the purpose of bringing it about (does not include general auxiliary or preparatory activities);
- some or all of the sales income is not attributed to a PE of the nonresident; and
- the arrangement defeats the purpose of the PE provisions in a relevant tax treaty.

If a PE is deemed to exist, the normal profit attribution rules will apply to determine the tax payable in New Zealand at the standard corporate rate, and the taxpayer will also be liable for a 100 percent penalty for taking an abusive tax position. Other treaty provisions will also apply; for example, royalties paid by the PE to another nonresident may be subject to New Zealand withholding tax.

Related changes have been proposed for New Zealand's source rules to ensure income of the deemed PE has a New Zealand source and that the same tax outcome arises when no tax treaty applies.

F. Purpose Test

The avoided PE rules in the U.K., Australia, and New Zealand, as well as the DPT rules in Australia, all include as a requisite condition a test assessing the purposes of the arrangements or persons undertaking the arrangements.

1. U.K.

In the U.K., the test is whether "one of the main purposes" of the arrangement is to avoid or reduce U.K. corporation tax. Those words are given their ordinary meaning, and the government has taken the view that it will usually be clear if one of the main purposes is tax avoidance; for example, if an arrangement would not have been entered into were it not for the tax advantage, or if any nontax objective was secondary to the tax advantage.

2. Australia

In Australia, one requirement for the MAAL or DPT to apply is the existence of a person who enters into the scheme for a principal purpose of enabling at least one taxpayer to obtain a tax benefit, or to obtain a tax benefit and reduce at least one taxpayer's foreign tax liabilities. According to the government, that principal purpose test is easier to satisfy — that is, it has a lower evidentiary threshold — than a dominant purpose test, such as the one in Australia's general antiavoidance rule.[4] That may well be the case, but the scope of the test's application is unclear.

Perhaps it will be clarified by the courts, as was the case with the "not incidental purpose" test in Australia's GAAR that was meant to attack schemes involving the trading or streaming of imputation (franking credit) benefits. In *Mills v. Commissioner*, [2012] HCA 51, the commissioner determined that an imputation credit was unavailable to holders of securities issued by the Commonwealth Bank because the bank had entered into a scheme so that the security holders

[4] *Id.* at 8.

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could obtain imputation benefits. The High Court of Australia held that, although in issuing the particular securities the bank had a purpose of enabling the holders to obtain imputation benefits, that purpose was incidental to its purpose of raising Tier 1 capital. Accordingly, because the commissioner did not meet the necessary precondition to make such a determination, the Court found for the taxpayer. In considering the scope of the not incidental purpose test, the Court said:

> A purpose can be incidental even where it is central to the design of a scheme if that design is directed to the achievement of another purpose. Indeed the centrality of a purpose to the design of a scheme directed to the achievement of another purpose may be the very thing that gives it a quality of subsidiarity and therefore incidentality.

Similarly, the principal purpose test may not be as easy to satisfy as it appears at first blush. At the least, its scope and nature are unlikely to be known for many years, and then only after appropriate judicial consideration.

The Australian government has said the principal purpose test reflects language in BEPS action 6 (preventing the granting of treaty benefits in inappropriate circumstances) and has justified its use by saying that Australia's GAAR should be consistent with the BEPS project.[5]

3. New Zealand

In anticipation that not all its tax treaty partners will opt into the widened PE definition recommended by the OECD, New Zealand has focused on the transaction's effect in its proposed measure. The proposal considers whether an arrangement defeats the purpose of the applicable treaty's PE provisions and outlines several factors that echo those in the Australian MAAL.

Although no legislative criteria are available, the discussion draft includes the catchall "any [other] indicators of PE avoidance." That broad language and the test itself indicate a wider application and a lower threshold compared with Australia's MAAL. The more objective approach proposed in New Zealand could avoid the need for Inland Revenue to inquire into the subjective purpose of the arrangement. However, given that the proposals are at a very early stage, it remains to be seen whether the test will dovetail with the Australian purposive approach.

G. Procedure

Both the U.K. and Australia have implemented special rules for the administration of their DPTs.

1. U.K.

If they believe the DPT applies, taxpayers must self-assess and notify HM Revenue & Customs within three months of the end of the accounting period. HMRC then has two years (or four years if no notification is made) to issue an assessment. The four-year limit is consistent with HMRC's normal assessment period for corporation tax. The agency has 12 months following the issuance of an assessment to increase or decrease the tax. The tax must be paid within 30 days, regardless of whether the taxpayer disputes the assessment.

2. Australia

There is no DPT self-assessment, and the Australian Taxation Office (ATO) has seven years (rather than the usual four years) to issue an assessment. (It is unclear why the ATO requires a longer period, although that length of time matches the assessment period under the new transfer pricing rules.) The tax must be paid within 21 days, regardless of whether the taxpayer disputes the DPT assessment.

Like HMRC, the ATO also has 12 months to review the assessment and increase or decrease the DPT. However, the rules not only prohibit taxpayers from objecting to the assessment during the review period, but also prevent them from relying on any evidence that is not disclosed to the ATO during that time. Further, that evidence will be inadmissible in an appeal against the assessment except in limited circumstances. The U.K. has no equivalent restriction in its DPT legislation.

The rationale behind that limitation is to encourage complete and accurate taxpayer disclosure. In its review of the draft DPT legislation, the Senate Economics Legislation Committee stated that measures like that are

[5] *Id.* at 22.

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necessary to prevent MNEs from "gaming the system."

The cumulative effect of those procedural requirements is to place greater pressure on taxpayers to provide the commissioner with all available information and documents during the review period. In effect, taxpayers will have to perform the type of evidence gathering required in litigation — but even before an objection is lodged or determined. That effectively moves a substantial portion of the litigation preparation work up in the timeline and means that if a taxpayer successfully appeals a DPT assessment, it will be unable to recover those costs because they will be incurred before court proceedings begin.

3. New Zealand

While New Zealand will not be introducing a DPT, the discussion draft proposes administrative measures to target uncooperative MNEs. Under the proposed rules, for large MNEs considered noncooperative, Inland Revenue could issue assessments earlier based on information held at the time; impose penalties for failure to comply with information requests; and require an upfront payment of disputed taxes stemming from transfer pricing, source rules, or the application of a tax treaty. It is unclear how a taxpayer would be classified as noncooperative, but the threshold must be considered carefully, given the severe consequences.

The discussion draft also proposes providing Inland Revenue with stronger information-gathering powers that would target large MNEs — for example, direct power to request information or documents that are held by, or accessible to, a group member based offshore, and the ability to impose a conviction for failing to provide information held by an associated offshore group member. The New Zealand government has said it considers those changes necessary, despite acknowledging increased transparency resulting from the OECD's CbC reporting rules and recent improvements in information exchange between revenue authorities.

III. Addressing the Risk of Double Taxation

A. U.K.

The U.K. does not allow a deduction for any DPT paid, but the DPT rules do avoid double taxation within the U.K. Companies are entitled to a credit against DPT (on a just and reasonable basis) for U.K. or foreign taxes that are calculated and paid by reference to the same profits as liable for DPT. Credit is also provided for controlled foreign company charges over the same profits.

For international taxation, the U.K. government's view is that the DPT is separate from U.K. income and corporation tax, and so is not covered by tax treaties. Further, the OECD commentary on the Model Tax Convention on Income and on Capital provides that states can deny treaty benefits if arrangements have a main purpose of obtaining tax benefits contrary to the treaty's object and purpose.

B. Australia

As in the U.K., a taxpayer liable for DPT is not entitled to a deduction. However, the DPT is also not reduced by the amount of foreign tax paid on the diverted profit and there is no entitlement to a foreign income tax offset, which provides relief from double taxation by entitling an Australian taxpayer to a credit for any foreign tax paid in another country.

Bilateral tax treaties prevail over Australian domestic laws other than the GAAR provisions, which contain the DPT and MAAL. A potential consequence of that exception is that taxpayers could be subject to double taxation on the same profits in two jurisdictions.

C. New Zealand

One reason the New Zealand government decided not to impose a DPT was its incompatibility with other domestic taxes and attributes, such as the availability of grouping, offsetting losses, and tax credits. However, MNEs that are caught by the proposed PE antiavoidance rule will be subject to a 100 percent tax penalty. As such, the same problem of incompatibility associated with imposing a DPT would still exist — with a penalty. The discussion draft does not directly address the topic of foreign tax credits for the attributed income of a deemed PE, but it is expected that they should be available.

As with the U.K. DPT and the Australian MAAL, if a PE is deemed to exist under the proposed New Zealand measures, the nonresident will be unable to argue that the PE

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article of an applicable tax treaty prevents New Zealand from taxing the relevant income. That presents a risk of double taxation if the nonresident's jurisdiction does not allow a credit for tax paid in New Zealand. The New Zealand government's position on that is the same as Australia's and the U.K.'s — that is, it has a right to deny a treaty benefit when an arrangement has the main purpose of obtaining a tax benefit contrary to the treaty's object and purpose.

IV. Actual and Anticipated Outcomes

A. U.K.

The DPT has been in force for two years. When it was first announced in the 2014 autumn statement, the U.K. government anticipated raising £250 million in the first year, increasing to over £355 million by the 2019-2020 tax year. In the 2017 spring statement, the forecasts had been reduced to about £100 million each year from the 2016-2017 tax year on.

Reasons have not been provided for the reduced forecast revenues. It is possible that the level of avoidance (in the sense sought to be captured by the DPT) in the U.K. market is not as prevalent as first thought, or that that behavior is being captured by other antiavoidance provisions, such as transfer pricing. HMRC is also well within the period when it can issue charging notices, so it might soon use its new tools more aggressively.

Another explanation is that MNEs may have changed their structures so the DPT would not apply. In May 2015, just one month after the DPT came into effect, it was reported that Amazon would begin booking its sales to U.K. customers in the U.K., rather than diverting those sales to Luxembourg as it had been doing for the previous 11 years.[6]

B. Australia

The Australian government has predicted that its DPT will raise AUD 100 million per year from the 2019 fiscal year, but has said the MAAL's financial impact is unquantifiable. It remains to be seen whether the predicted revenues materialize, or whether, like the U.K., Australia will need to lower its expectations.

Behavioral changes such as Amazon's are arguably the outcomes that governments are seeking to achieve with initiatives such as the DPT and the MAAL rather than directly raising revenue. In a recent speech, the Australian Commissioner of Taxation Chris Jordan observed that following the introduction of the MAAL:

> We are seeing positive changes in behaviour from taxpayers and their advisors. They are abandoning their contrived structures and restructuring to models whereby the sales are booked in Australia. They are changing transfer pricing methodology and amounts to better reflect the value creation within Australia, recognising a taxable presence here, and removing shell entities and long-term foreign agency arrangements.[7]

C. New Zealand

In its discussion draft, the New Zealand government indicated that its goal is to discourage MNEs from pursuing avoidance schemes and to encourage them to voluntarily comply, rather than directly raising revenue.

V. Interaction With the BEPS Project

Despite taking unilateral action, the U.K. and Australian governments have maintained their commitment to the BEPS project. Australia has justified its actions by pointing to the fact that the OECD has asked countries to review their domestic laws to ensure they complement OECD transfer pricing reforms and arguing that its DPT does so. However, unilateral action could be viewed as an indication that Australia and the U.K. might not be confident that the BEPS reforms will adequately address problems in a timely manner, or at all.

Similarly, while New Zealand is committed to the BEPS project, the proposals in its discussion draft — while less aggressive than approaches by

[6]Vanessa Houlder, "Amazon Starts to Book UK Sales in Britain," *Financial Times*, May 22, 2015; and Simon Bowers, "Amazon to Begin Paying Corporation Tax on UK Retail Sales," *The Guardian*, May 23, 2015.

[7]Keynote address at the Tax Institute's National Convention in Adelaide, Australia (Mar. 16, 2017).

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the U.K. and Australia — could be taken to mean that its government has similar concerns regarding the project's ability to ensure MNEs pay their fair share of tax.

By departing from the OECD process and timetable, there is a risk that the U.K., Australia, and New Zealand will hinder the OECD's attempts to harmoniously reform global tax laws.

On November 24, 2016, the OECD released its Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI), a project chaired by a U.K. representative. The MLI will modify bilateral tax treaties only if both jurisdictions are signatories to it and have made choices that are not incompatible with it.

Countries also have the option of making reservations and notices. The U.K. government has already noted that it will not adopt many of the changes to the PE concept in its tax treaties, saying those concerns will have been addressed by the avoided PE limb of the DPT. That could make negotiations difficult if the other treaty party would prefer to address PEs in their treaties rather than in domestic legislation.

Because the U.K. and other trading partners are reluctant to adopt the OECD's widened PE definition, the New Zealand government is also proposing to unilaterally override its tax treaties with those trading partners with the introduction of the proposed PE antiavoidance provision. Despite that, the government has signaled its intent to implement all applicable minimum standard and optional provisions to prevent treaty abuse, including strengthened tax treaty PE provisions and the new principal purpose test. New Zealand is expected to sign the MLI in mid-2017.[8]

Australia released a consultation paper in December 2016 in which the government acknowledged that although it has yet to make a final decision on adopting the MLI, in its view "signing and adopting it to the widest possible extent would be consistent with Australia's strong track record on tackling multinational tax avoidance."

The MLI also provides a modified version of the mutual agreement procedures in treaties, which apply when a taxpayer claims it is not being taxed in accordance with the treaty. The modifications include new rules on arbitration procedures and now allow taxpayers to present their cases in either contracting state (rather than just the state in which they are resident). The U.K. government plans to adopt the new MAP in full but because the DPT is not considered a tax covered by the treaties, access to the MAP will not be available if the DPT applies. MNEs will also face the same problem in Australia (for the DPT and MAAL) and in New Zealand (for a deemed PE).

In a white paper published in August 2016, the U.S. Treasury Department noted the importance of addressing tax avoidance by MNEs multilaterally. It objected to the European Commission's unilateral action in its state aid investigations into U.S. technology companies, saying actions like that undermine international collaborative efforts and would have considerable implications for U.S. revenue and companies.

It is unclear how countries with which the U.K., Australia, and New Zealand have tax treaties will handle any claims of double taxation resulting from an application of the DPT and MAAL. If the U.S. reaction is any indication, there may be significant diplomatic wrangling to come.

VI. Conclusion

Globalization of the world economy in the digital age has highlighted the inadequacies of antiquated tax rules. Unilateral DPT introduction by the U.K. and Australia (including the MAAL by Australia) and proposed measures in New Zealand, all of which operate outside the scope of the BEPS project, could seriously undermine OECD attempts to reform international tax laws.

There is sustained international pressure on MNEs to change their behavior, and the DPT and MAAL are just more tools to exert that pressure. The BEPS project, government inquiries, commission state aid investigations, and the media generally continue to pressure MNEs to pay the perceived appropriate amount of tax in the appropriate place.

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[8] Inland Revenue, "New Zealand's Implementation of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS," Official Issues Paper (Mar. 2017), at [1.14].

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While New Zealand's proposed measures are in their early stages, the New Zealand government has confirmed that it does not need to go as far as implementing a DPT. Details of the test for the proposed PE antiavoidance rule have yet to be fleshed out through the legislative process, but it appears from the discussion draft that New Zealand's rules could apply to a broader set of arrangements than Australia's MAAL does.

Arguably, the role of any government is to balance the need for raising revenue against the desire to encourage investment to stimulate economic activity. However, the U.K., Australia, and New Zealand must be careful not to swing the pendulum too far one way. It remains to be seen whether they have done that.

MNEs will be forced to rethink the jurisdictions where they undertake foreign investment, which may create opportunities for other countries to exploit unilateral actions and offer incentives to attract MNE investment at the expense of the U.K., Australia, and New Zealand. ■

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