TAX LAW IMF TECHNICAL NOTE

VOLUME 1
01 | 2016

INTRODUCING A GENERAL ANTI-AVOIDANCE RULE (GAAR)

Christophe Waerzeggers | Cory Hillier

INTERNATIONAL MONETARY FUND | IMF LEGAL DEPARTMENT

TAX LAW IMF TECHNICAL NOTE

VOLUME 1
01 | 2016

INTRODUCING A GENERAL ANTI-AVOIDANCE RULE (GAAR)

Christophe Waerzeggers | Cory Hillier

INTERNATIONAL MONETARY FUND | IMF LEGAL DEPARTMENT

January 2016

Waerzeggers, Christophe and Cory Hillier, 2016, "Introducing a general anti-avoidance rule (GAAR)—Ensuring that a GAAR achieves its purpose," Tax Law IMF Technical Note 2016/1, IMF Legal Department

This Tax Law Note was prepared by the tax counsels of the IMF's Legal Department. This Tax Law Note should not be reported as representing the views of the IMF. The views expressed in this Tax Law Note are those of the authors and do not necessarily represent those of the IMF or IMF policy.

INTRODUCING A GENERAL ANTI-AVOIDANCE RULE (GAAR)

ENSURING THAT A GAAR ACHIEVES ITS PURPOSE

I. EXECUTIVE SUMMARY

Many jurisdictions have adopted a general anti-avoidance rule (GAAR) while others are considering the introduction of one or are otherwise seeking to fine-tune their existing rule. Countries with a GAAR include the UK, France, Germany, The Netherlands, Belgium, Canada, China, Singapore, Italy, South Africa, Kenya and Australia. The introduction of a GAAR also continues to be topical in many other jurisdictions such as India and Poland. Australia has also recently amended its GAAR to address specific base erosion and profit shifting (BEPS) concerns.

The ultimate purpose of a GAAR is to stamp out unacceptable tax avoidance practices. A GAAR is a provision of last resort that is capable of being invoked by a tax authority to strike down unacceptable tax avoidance practices that would otherwise comply with the terms and statutory interpretation of the ordinary tax law. A GAAR is typically designed to strike down those otherwise lawful practices that are found to be carried out in a manner which undermines the intention of the tax law such as where a taxpayer has misused or abused that law. This is typically achieved by giving the tax authority the power to cancel a particular tax benefit or assess a different (increased) tax liability against the taxpayer in circumstances where the course of action taken by a taxpayer is so blatant, artificial or contrived that it is only explicable by the desire to obtain a relevant tax benefit.

However, the stated objective of stamping out unacceptable tax avoidance can itself make the legal design of a GAAR complex. This is simply because the phrase “tax avoidance” means different things to different people. Whatever the form of a GAAR, it should give effect to a policy that seeks to strike down blatant, artificial or contrived arrangements which are tax driven. However, the GAAR should be designed and applied so as not to inhibit or impede ordinary commercial transactions in respect of which taxpayers can legitimately take advantage of opportunities available to them when structuring or carrying out those transactions.

When considering the introduction of a GAAR close attention should be paid to the legal design and the available administrative capacity and infrastructure. Drawing the line between transactions that are, and are not, caught by the GAAR will always be a matter of degree and will often be delicate. Therefore, the success of a GAAR in achieving its purposes will ultimately depend on (1) the legal design and drafting of the GAAR, and (2) the capacity of the tax authority to appropriately apply the GAAR in a measured, even handed and predictable way. Some countries have established dedicated GAAR panels for this purpose. The country’s infrastructure to settle tax disputes should also be taken into account as the broad powers that a GAAR confers on the tax authority require adequate taxpayer safeguards. For these reasons, the implementation of a GAAR in developing countries needs to be more carefully managed.

Most recently, Australia has amended its GAAR to address specific BEPS concerns. The amendments were announced as part of the Government’s May 2015 budget and are contained in the recently enacted Tax Laws Amendment (Combating Multinational Tax Avoidance) Bill. The amendments are intended to combat specific BEPS practices of certain multinationals groups deemed unacceptable in connection with the OECD/G20 BEPS Project. This recent development also highlights some of the key legal design considerations when developing or amending a GAAR and so is discussed further below.

©International Monetary Fund. Not for Redistribution

II. OVERVIEW OF THE APPLICATION OF THE SAMPLE GAAR

A sample generic GAAR is set out at Appendix A. This sample GAAR is general in nature and in the form of a simplified legal provision. Importantly, it does not take into account the individual circumstances of any particular tax system. The ultimate form of any GAAR to be adopted by any given country would need to take into account the specific legal tradition and system—including any constitutional limitations—as well as the political and administrative structure and fiscal policies of the country concerned.

Subject to specified conditions the sample GAAR allows the tax authority to make a determination and assess a different (increased) tax liability against the taxpayer. Briefly, such a determination may be made in the following circumstances:

- There is a "scheme" that results in the taxpayer receiving a "tax benefit"; and
- Having regard to the substance of the scheme, it can be concluded objectively that the taxpayer or one of the persons who entered the scheme, did so for the sole or dominant purpose of enabling the taxpayer to obtain that tax benefit.

Importantly, the GAAR is not self executing. Rather, the tax authority must decide to make, and must make, a relevant and valid determination before the GAAR applies. The application of a GAAR therefore invariably requires the tax authority to make an assessment.

A GAAR can apply to different taxes and take different forms. While the remainder of the discussion broadly focuses on income tax, jurisdictions have developed GAARs to also cover other taxes such as VAT/GST and other transaction taxes like stamp duties. Furthermore, a GAAR may be introduced by statute—as shown by the sample GAAR in Appendix A—or can be based on case law.[1] Broadly speaking the features of these GAARs are similar to those of the sample rule discussed in this note.

III. DETAILED ANALYSIS OF THE APPLICATION OF THE SAMPLE GAAR

The sample GAAR contains a number of conditions which must be satisfied before the provision can be invoked by the tax authority. These conditions are discussed in more detail in this section.

A. Scheme

Firstly, there must be a "scheme." "Scheme" is widely defined to include any course of action, agreement, arrangement, understanding, promise, plan, proposal, or undertaking, whether express or implied and whether or not enforceable. It is possible either that:

- The whole of a transaction or dealing may be identified as the relevant "scheme"; or
- That merely some component of the transaction (or combination of components) may be identified as the "scheme."

It is often important that the tax authority is given sufficient flexibility as to how the "scheme" is identified and defined. This is because, if the whole of an arrangement consists of a series of transactions or steps, the tax authority should be permitted to select some aspect of that overall arrangement where the particular aspect selected, of itself, makes sense as a "scheme" which is motivated by tax considerations.

B. Tax benefit

Secondly, there must be a "tax benefit" in connection with the scheme. A "tax benefit" is defined under the sample GAAR as:

"tax benefit" means:

(a) *a reduction in a liability to pay tax, including on account of a deduction, credit, offset or rebate;*

(b) *a postponement of a liability to pay tax;*

(c) *any other advantage arising because of a delay in payment of tax; or*

(d) *anything that causes:*

 (i) *an amount of gross revenue to be exempt income or otherwise not subject to tax; or*

 (ii) *an amount that would otherwise be subject to tax not to be taxed.*

[1] This is the case, for instance, with the 'abuse of law' doctrine developed by the EU Court of Justice in the areas of EU customs law (C-110/99 Emsland-Stärke), EU VAT (C-255/02 Halifax and others) and EU law as far as it applies to corporate income tax (C-196/04 Cadburry Schweppes).

©International Monetary Fund. Not for Redistribution

This is a simplified and generic example and must be tailored to the situation. A tax benefit can take many different forms, such as a deduction, relief, rebate, credit, offset or refund, as well as a reduction in either a tax liability, amount of income or a tax base, including an increase in a tax loss. The GAAR must therefore be tailored to the individual circumstances of any particular tax system to ensure it has a wide enough scope.

However, as a general principle, a tax benefit in connection with a scheme should not extend to incentives or concessions specifically provided for in the tax law. This would normally be the case for benefits such as the ability to make an available tax election, claim accelerated tax depreciation on the purchase of certain encouraged assets, or the claiming of a specific tax deduction for a bad debt, which a taxpayer takes advantage of in a manner consistent with the policy intent of the relevant tax incentive or concession. This is consistent with the idea that if a particular tax incentive, concession or regime has been enacted into the tax laws to encourage a set of behaviors or economic activity, then the GAAR should not apply if a taxpayer legitimately adopts the encouraged behavior or undertakes the intended economic activity. However, this principle should not be unqualified. For example, the GAAR could still apply where an available tax concession is exploited through contrived or artificial steps (as discussed further below). Some jurisdictions (e.g. Canada) have adopted an additional legislative requirement before being able to invoke the GAAR that any tax benefit must be obtained in a manner that constitutes a misuse or abuse of the provisions of the tax law. An additional legislative requirement of this nature could also be considered.

Identifying and quantifying a tax benefit and establishing causality with a scheme can give rise to complexities and warrants attention when designing a GAAR. For the GAAR to apply the tax benefit in question must have arisen from the scheme. A common complexity arises in circumstances where it becomes necessary when identifying the tax benefits associated with a scheme to have regard to what the relevant taxpayer would have reasonably done in the absence of the scheme (i.e. determining a relevant counterfactual). This would arise where the identification and calculation of the tax benefit arising as a result of the current scheme must necessarily be determined by reference to the (increased) tax payable under the relevant counterfactual (i.e. the tax that would have become payable had the taxpayer taken an alternative course of action). This examination can be complex because there may be a multitude of actions that the taxpayer could have undertaken in the alternative, all potentially giving rise to a different quantum of tax liability. In some jurisdictions this has led to the "do nothing" defense, i.e. where the taxpayer argues that it would have reasonably refrained from undertaking the particular transaction or dealing such that it would have "done nothing" in the alternative. Where available, this defense typically advantages:

- The taxpayer, in income cases (e.g. the taxpayer argues that it would have "done nothing" in the alternative such that no amount would have been included in its taxable income and therefore no "tax benefit" would have arisen compared to that particular counterfactual); and
- The tax authority, in deduction cases (e.g. the effect of arguing the "doing nothing" approach in deduction cases is that no deduction would have arisen, which would typically concede a relevant "tax benefit" in connection with the scheme undertaken).

An effective GAAR would therefore typically provide further clarity in relation to the process for identifying and quantifying a tax benefit. Such further guidance can be provided in the law, relevant regulations or accompanying guidelines.

C. Sole or dominant purpose

Lastly, for the scheme to be caught by the GAAR it must be shown that the taxpayer's sole or dominant purpose was to obtain the identified tax benefit. In accordance with the sample GAAR, the requisite purpose must be found having regard to the substance of the scheme. This could involve an examination of the following matters in order to make a determination in relation to the substance of the scheme so as to make a finding of purpose:

- The manner in which the scheme was carried out;
- Whether any artificiality or contrivance is evident in relation to that scheme;
- Whether there is a divergence between the form and substance of the scheme; and
- The result achieved by the scheme (e.g. reduction in income or increase in deductions) as compared to the result under a relevant counterfactual.

©International Monetary Fund. Not for Redistribution

To avoid inhibiting or impeding ordinary commercial transactions, the GAAR's purpose test must be applied objectively and in a considered way. In this regard, after considering the relevant facts, circumstances and evidence, it should be able to be objectively concluded that obtaining the identified tax benefit, of itself, explains why the taxpayer entered into the particular transaction or dealing (scheme). Importantly, the taxpayer's subjective state of mind, and therefore also their actual fiscal motives, should not technically be relevant when applying the "sole or dominant purpose" test objectively. In this regard, evidence as to the actual purpose of a taxpayer, or what in fact was the taxpayer's actual purpose need not be considered. However, it would be expected that a taxpayer will often have to put on credible objective evidence which points to them—and possibly any other relevant person—having a dominant purpose which was something other than obtaining the identified tax benefit.

Drawing the line between transactions that are, and are not, caught by the GAAR can be a matter of degree. Practically speaking, where a scheme makes no commercial sense without the resulting tax benefits, there is a greater likelihood of concluding that it is entered into for the dominant purpose of obtaining a tax benefit. Further, the fact that a transaction was aimed at an overall profit-making objective or had a rational commercial purpose should not preclude the GAAR applying. However, in the context of an overall arrangement which achieves genuine commercial purposes, it would likely be necessary to identify a step (which itself makes sense as a "scheme") that was explicable only by the identified tax benefit being obtained. In this sense, the mere fact that a tax benefit has been obtained should not, of itself, justify the application of the GAAR. An objectively ascertained sole or dominant purpose must also be found.

Any GAAR must operate in a world where tax laws influence the shape of nearly every commercial transaction or dealing. Just because it could be concluded, on the basis of the objective facts, that a taxpayer had tax advantages in mind in choosing a particular structure does not mean that the GAAR should necessarily apply to the scheme. The question should not be whether the taxpayer could have chosen a less tax effective means of achieving their commercial objective. Rather, it should be whether it was reasonable to conclude that their dominant purpose was to obtain the identified tax benefit. This means that even if it could be concluded that aspects of a scheme were tax driven, if the dominant purpose of the relevant taxpayer, objectively assessed, was a commercial one, then the requisite purpose test should not be satisfied in respect of the tax benefit obtained. This is because the ultimate purpose of a GAAR is to combat only contrived or artificial forms of tax planning.

A taxpayer should therefore not be required to take a course of action which always results in the highest level of taxation where there are ordinary commercial reasons for the actual course taken. For example, a GAAR should not operate to impede a taxpayer's legitimate financing choice between debt (where returns are ordinarily deductible) and equity (where returns are typically non-deductible) particularly where the nature of the financing instrument chosen also has key (non-tax) legal, commercial and accounting benefits and consequences. Any such tax limitation would be the role of a specific integrity provision to give effect to a specific policy formulation such as a rule against thin capitalization. Accordingly, the form of the transaction may be tax driven, yet the scheme giving rise to the transaction may be one to which the GAAR does not apply.

The balance between legitimate tax planning and a scheme that would be caught by a GAAR is often delicate and is best demonstrated by the example below.

IV. EXAMPLE

Company A distributes soap products in Country A.

Company B distributes soap products in Country B.

Each of those companies purchases the soap products for $50 per box (containing 100 bars) from a local manufacturer in circumstances where those products can subsequently be sold to meet local market demand for a retail value of $80 per box. Therefore, each of those companies is expected to realize an economic gain of $30 per box on the sale of their respective soap products.

The markets for soap products in Country A and Country B are substantially the same in terms of both product demand, product preference and retail price. Company A and Company B each distributes and sells substantially the same generic soap products.

©International Monetary Fund. Not for Redistribution

	COMPANY A	COMPANY B	OBSERVATIONS
Transaction 1: Initial export sale			
Export price	$79	$79	(sale price by Company A to Company B and vice versa)
Cost	($50)	($50)	(purchase price from local manufacturer)
Gain	$29 (economic) $0 (taxable)	$29 (economic) $0 (taxable)	Economic gain is sheltered from tax by export exemption
Transaction 2: Subsequent retail sale			
Retail price	$80	$80	(sale price to local retail customers)
Cost	($79)	($79)	(purchase price paid by Company A to Company B and vice versa)
Gain	$1 (economic) $1 (taxable)	$1 (economic) $1 (taxable)	Economic gain of $1 is taxable as imported products are sold in domestic market
Total gain (under transaction 1 and 2)	$30 (economic) $1 (taxable)	$30 (economic) $1 (taxable)	
Counterfactual **If products only sold in domestic market rather than initially exported…**			
Retail price	$80	$80	(sale price to local retail customers)
Cost	($50)	($50)	(purchase price from local manufacturer)
Gain	$30 (economic) $30 (taxable)	$30 (economic) $30 (taxable)	Economic gain of $30 would have been taxable as products sold solely in domestic market and not exported.

Country A and Country B have each introduced a tax incentive regime to encourage international exports. Neither regime contains any specific integrity provisions which seek to preserve the policy intent of only allowing the exemption for genuine export arrangements.

Suppose Company A and Company B were to enter into the following arrangement:

- Company A agrees to sell (export) the soap products held by Company A to Company B for $79 per box (in accordance with transfer pricing principles).
- Company B also agrees to sell (export) the soap products held by Company B to Company A for $79 per box.
- Company A subsequently sells the soap products acquired from Company B to retail customers in Country A for $80 per box.
- Company B subsequently sells the soap products acquired from Company A to retail customers in Country B for $80 per box.

The economic and tax position of Company A and Company B can be summarized as set out in the table above.

©International Monetary Fund. Not for Redistribution

Based on the table, it would be reasonable to expect that the conditions of the sample GAAR (at Appendix A) would be satisfied, for the following reasons:

- *The arrangement between Company A and Company B gives rise to a scheme.* Importantly, this should be the case irrespective of whether the arrangement is formally documented or, alternatively, merely takes the form of a verbal agreement or mutual understanding on the basis that "scheme" is widely defined to capture any course of action, agreement or understanding whether express or implied and whether or not enforceable.
- *There is a "tax benefit" in connection with the scheme.* A "tax benefit" should be found to exist as defined either because there is an arrangement (scheme) that causes an amount of gross revenue to be exempt income or because of that arrangement (scheme) an amount that would otherwise be subject to tax is not taxed. In each case, it is reasonable to expect that the tax benefit in question arose as a result of the scheme, particularly when regard is had (if it becomes necessary to do so) to what the relevant taxpayer would have reasonably done in the absence of the scheme (i.e. under a relevant counterfactual). A reasonable counterfactual in these circumstances (as outlined in the table above) would consist of the taxpayer selling the products acquired from the manufacturer in the domestic market without taking the intermediate step of selling those products cross-border in order to take advantage of the export exemption. This counterfactual should be considered reasonable on the basis that substantially the same products are ultimately sold by each of Company A and Company B in their own domestic market.
- *It would be reasonable to conclude that the sole or dominant purpose of the relevant taxpayer in entering into or carrying out the scheme was to obtain a tax benefit.* This is because:
  - The manner in which the scheme was carried out consists of the mutual export of substantially the same soap products. The fact that the products being exchanged (or mutually exported) between Company A and Company B are substantially the same suggests an artificiality or contrivance in relation to the scheme.
  - Further, there is arguably a divergence between the form and substance of the scheme. The form of the scheme consists of an export of products between Company A and Company B whereas the substance of the scheme could be said to be the domestic sale of products through a transaction structure which results in substantially all of the economic gain from the sale of those products being sheltered by the tax exemption for exports.
  - The result achieved by the scheme is, therefore, the sheltering of substantially all of the economic gain from the sale of the products by taking advantage of the export exemption (i.e. the result is a tax exempt gain of $29 per box out of total economic gain of $30 per box). This can be compared to the result which could reasonably be expected to have arisen if those products were simply sold on the domestic market without the intermediate step of "exporting" those products which would have resulted in the entire economic gain from the sale of the products being taxable (i.e. taxable gain and economic gain would have been equal to $30 per box).

The above demonstrates a key observation when determining whether the relevant considerations point to a sole or dominant purpose of the taxpayer entering into the scheme to obtain a tax benefit. In this regard, the conclusion that the sole or dominant purpose of Company A or Company B in entering into the export scheme was to each obtain a tax benefit:

- Should not be *simply* drawn from the intention to obtain the export exemption (which is specifically provided for in the tax law of both Country A and Country B);
- *But* arises because Company A and Company B took contrived or artificial steps to shelter from tax substantially all of the economic gain from what was, in substance, a domestic sale of products by adopting a transaction structure that took advantage of the tax exemption for exports and they did so in a manner which objectively indicated the presence of a dominant purpose to obtain a tax benefit.

As noted above, a GAAR should not have the result that a taxpayer is obliged to take a course of action which always results in the highest level of taxation where the actual course taken is explicable according to ordinary commercial reasons.

Relevantly, suppose, instead, the following arrangements were entered into by Company A in the context of the above example:

- Company A genuinely exported the soap products held by Company A to Company B (with no corresponding

©International Monetary Fund. Not for Redistribution

import from Company B) (scenario 1); or

- Company A exported the soap products held by Company A to Company B with a corresponding import from Company B of a different product (e.g. cleaning products) for subsequent distribution and sale in order to satisfy different market demands (scenario 2).

In each of these scenarios, absent further facts, it would not be reasonable to apply the GAAR, for the following reasons:

- A decision by Company A to export the soap products rather than sell those products on the domestic market should not, of itself, be sufficient to attract the GAAR (particularly given that a tax exemption for exports is specifically provided for in the tax law of Country A). In this regard, the GAAR should not apply where the form and substance of the scheme are aligned in the sense of a genuine export arrangement being undertaken by Company A; and
- Further, under scenario 2, the products which are the subject of the mutual export arrangement are substantially different and address specific market and commercial needs such that, even if a "tax benefit" could be established, it would not be reasonable to conclude that the sole or dominant purpose of Company A in entering into or carrying out the export scheme was to obtain the tax benefit in the form of the export exemption. More specifically, the course of action taken by Company A, even if found to be motivated by the desire to take advantage of the export exemption, is also explicable by ordinary commercial considerations such that those tax advantages could not reasonably be considered to be the "sole or dominant purpose" of entering into or carrying out the export scheme.

However, the position is more complex if the factual circumstances are not easily distinguishable from the original example. For example, what if Company A exported the soap products held by Company A to Company B with a corresponding import from Company B of a soap product with different characteristics (e.g. different scent, ingredients, packaging, etc)?

In these circumstances, drawing the line between whether this example should be caught by the GAAR will be a matter of degree and will be delicate. It would typically depend on the strength of the available evidence to establish objective facts from which it could be established that a reasonable person would conclude that the "dominant purpose" of Company A (or another person who entered into or carried out the scheme) was to enable Company A to obtain any identified tax benefit. This may depend on how compelling the objective evidence was to establish that the scheme was also explicable by reference to ordinary commercial considerations (e.g. the extent to which the product differentiation between the respective soap products was important for the different markets in Country A and Country B, etc).

V. APPLYING THE GAAR IN PRACTICE

The sample GAAR is not self executing and requires the tax authority to make a relevant and valid determination before the GAAR applies. The process for applying the sample GAAR provision can be summarized as follows:

- The tax authority may determine the tax liability of the person who obtained the tax benefit as if the scheme had not been entered into or carried out, or as if a reasonable alternative to entering into or carrying out the scheme would have instead been entered into or carried out, and can make compensating adjustments to the tax liability of any other person affected by the scheme.
- The tax authority must issue an assessment giving effect to the determination or adjustment.
- An assessment must be served within 5 years from the last day of the tax year to which the determination or adjustment relates.

The appeal or objection process available to taxpayers would typically depend on the structure of the individual country's domestic tax dispute processes. This would also determine who bears the burden of proof when a GAAR determination is challenged. In this regard, the design and strength of a country's administrative and judicial appeal process will also be important to the successful implementation of a GAAR.

Anti-avoidance provisions can also take different forms. The sample GAAR set out at Appendix A is general in nature and in the form of a simplified legal provision of general application. However, unacceptable tax avoidance practices can also be dealt with through other legal instruments or doctrines such as a specific

©International Monetary Fund. Not for Redistribution

legal provision of targeted application in domestic law (e.g. a specific anti-avoidance rule or SAAR), equivalent provisions to that of a GAAR or SAAR in tax treaties, and through judicial anti-abuse doctrines, as applicable.

A GAAR when introduced in domestic law needs to be carefully designed and drafted to achieve consistency with the country's existing international legal obligations such as those embodied in existing tax treaties. Certain complexities arise in circumstances where a new domestic provision is intended to act as a tax treaty override in respect of treaties already in force, as a tax treaty would commonly prevail over domestic law to the extent of any inconsistency. Although there is support for the general proposition that domestic anti-abuse provisions should not be considered inconsistent with tax treaties even when they predate such provisions, there are also counter arguments. Overall, it is generally accepted that domestic legislative and judicial doctrines applicable to the individual country concerned will inform the position. These complex conflict issues can be more easily managed in respect of future tax treaties on the basis that new treaties can be negotiated with regard to any tax treaty override provision that has been enacted in domestic law at the time the treaty is negotiated.

VI. RECENT DEVELOPMENTS

Many jurisdictions have adopted a GAAR, including the UK, France, Germany, The Netherlands, Belgium, Canada, China, Singapore, South Africa, Kenya and Australia. The introduction of a GAAR also continues to be topical in many other jurisdictions such as India[2] and Poland.[3] Italy also recently enacted its first modern GAAR.[4]

Recently the Australian Government has taken steps to combat the specific base erosion and profit shifting (BEPS) practices of certain multinationals. Such practices, identified in connection with the OECD/G20 BEPS Project, involve tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity, resulting in little or no overall corporate tax being paid. The OECD/G20 BEPS Project has developed a package of measures—largely comprising legal instruments—in order to address BEPS practices.[5]

Australia's immediate legislative response to these BEPS practices involved amending its existing GAAR. This measure was announced in connection with the Federal Budget handed down by the Australian Government on May 12, 2015 and the amendments are contained in the recently enacted *Tax Laws Amendment (Combating Multinational Tax Avoidance) Bill 2015*.[6] The key points relating to the Australian measure can be summarized as follows:

- The multinational anti-avoidance law is designed to counter the erosion of the Australian tax base by multinational entities using artificial or contrived arrangements to avoid the attribution of business profits to Australia through a taxable presence in Australia.
- It targets those multinational entities that:
  - avoid a taxable presence by undertaking significant work in Australia in direct connection to Australian sales but booking their revenue offshore; and
  - have a principal purpose of avoiding tax in Australia or a combined purpose of also reducing their foreign tax liability.
- The multinational anti-avoidance law has been introduced into Australia's existing GAAR but will only apply to foreign entities that are "significant global entities" (e.g. those with annual global income of AU$1 billion or more). This is intended to reduce

[2] In India, the applicability of its GAAR is to be deferred by 2 years in accordance with the announcement in the Budget for fiscal year 2015-16 which was presented to Parliament by the Finance Minister on 28 February 2015. Accordingly, the GAAR would be applicable from financial year 2017-18. Further, when implemented, the GAAR will apply prospectively to investments made on or after 1 April 2017.

[3] On 27 April 2015, the amended version of the proposed Tax Code (*Ordynacja Podatkowa*) was published in Poland which no longer contains the provision of general anti-avoidance rules (GAARs) that were planned to be introduced into the tax system.

[4] In Italy, the new GAAR was introduced with the Legislative decree n. 128 of 2015 and was effective from 1 October 2015.

[5] On 5 October 2015, the OECD presented the final package of measures intended to comprise a comprehensive, coherent and coordinated reform of the international tax rules. The package of measures was released in the context of the OECD/G20 Base Erosion and Profit Shifting (BEPS) Project (hereafter "the BEPS Package"). The BEPS Package was subsequently endorsed by the G20 leaders.

[6] The Australian action follows the action taken by the UK to develop its own domestic instrument in the form of a diverted profits tax (DPT) which is aimed at the same purpose.

©International Monetary Fund. Not for Redistribution

compliance costs and provide certainty to other taxpayers given that significant global taxpayers with structures at risk of falling within the scope of the new law are expected to seek advice on its potential application and, if at risk of being caught, may reassess the tax consequences of their existing structure or restructure their operations to remove the artificiality.

- Any multinationals that are found to be avoiding Australian tax under the new law would face a determination resulting in a tax liability for the tax avoided (plus interest) and face penalties of up to 100 per cent of the tax owed. This result is considered appropriate given the tax avoidance purpose of their actions.

A key legal design feature of the measure is that it uses a different purpose test. The new law uses a "principal purpose" test rather than the different (higher) standard of the "sole or dominant purpose" test used in the sample GAAR at Appendix A. It is also different to the existing standard adopted under Australia's existing GAAR which also adopts a sole or dominant purpose threshold. The existing standard which requires a "sole or dominant" purpose (of avoiding Australian tax) was considered to be inadequate to deal with the type of multinational tax avoidance being targeted. This is because a "sole or dominant" purpose (of avoiding Australian tax) test would be difficult to satisfy where the relevant multinational operates a global business where Australia is only one market in a global offering and the business structure is implemented to reduce the global tax impost (e.g. the tax avoidance scheme adopted is not a bespoke structure to deal with Australian tax only). Therefore, the new law also applies where a scheme is entered into or carried out for a number of principal purposes as long as one of those principal purposes had the requisite tax avoidance purpose (which can include a purpose of avoiding Australian tax, which when combined with another purpose of reducing a liability to tax under a foreign law, amounts to the principal purpose or one of the principal purposes of the relevant scheme).

Using the GAAR to combat BEPS is also a deliberate legal design feature to ensure compatibility and harmonization with other laws and tax treaty obligations. The Australian Government indicated that the new multinational anti-avoidance law reflects the need for immediate action to target the most egregious tax structuring by multinational entities, particularly while the implementation of the measures contained in the BEPS Package under the auspices of the OECD is still ongoing internationally. Importantly, the new law is not intended to have an adverse impact on legitimate international business activities (which is consistent with the overall objective of a GAAR, as discussed above). In these particular circumstances, the use of the GAAR provides a specific legislative action to combat the particular form of corporate tax avoidance of concern, without requiring substantive changes to existing laws or the introduction of a new tax.[7] While historically it has been unusual for a GAAR to target specific structures and a specific class of taxpayer, if the relevant anti-avoidance practice is widespread, then there is no reason why the GAAR could not be adapted to combat particular practices, structures or classes of taxpayer.

Prepared by: Christophe Waerzeggers and Cory Hillier

[7] As opposed to the UK's DPT which is designed as a standalone tax with its own charging and collection rules.

©International Monetary Fund. Not for Redistribution

APPENDIX A
SAMPLE GAAR

Set out below is a sample GAAR. It is important to note that this sample GAAR is general in nature and in the form of a simplified legal provision. Importantly, it does not take into account the individual circumstances of any particular tax system. The ultimate form of any GAAR to be adopted by any given country would need to take into account the specific legal tradition and system—including any constitutional limitations—as well as the political and administrative structure and fiscal policies of the country concerned.

Tax avoidance schemes

(1) This section applies when the Tax Authority is satisfied that:

(a) a scheme has been entered into or carried out;

(b) a person has obtained a tax benefit in connection with the scheme; and

(c) having regard to the substance of the scheme, it would be concluded that a person, or one of the persons, who entered into or carried out the scheme did so for the sole or dominant purpose of enabling the person referred to in paragraph (b) to obtain a tax benefit.

(2) Despite anything in this Act, when this section applies, the Tax Authority may determine the tax liability of the person who obtained the tax benefit as if the scheme had not been entered into or carried out, or as if a reasonable alternative to entering into or carrying out the scheme would have instead been entered into or carried out, and can make compensating adjustments to the tax liability of any other person affected by the scheme.

(3) If a determination or adjustment is made under this section, the Tax Authority must issue an assessment giving effect to the determination or adjustment.

(4) An assessment under subsection (3) must be served within 5 years from the last day of the tax year to which the determination or adjustment relates.

(5) In this section:

"scheme" includes any course of action, agreement, arrangement, understanding, promise, plan, proposal, or undertaking, whether express or implied and whether or not enforceable;

"tax benefit" means:

(a) a reduction in a liability to pay tax, including on account of a deduction, credit, offset or rebate;

(b) a postponement of a liability to pay tax;

(c) any other advantage arising because of a delay in payment of tax; or

(d) anything that causes:

(i) an amount of gross revenue to be exempt income or otherwise not subject to tax; or

(ii) an amount that would otherwise be subject to tax not to be taxed.

©International Monetary Fund. Not for Redistribution